Industrial Banking Companies and Their Credit Practices

BY RAYMOND J. SAULNIER

Financial Research Program
Studies in Consumer Instalment Financing 4

NATIONAL BUREAU OF ECONOMIC RESEARCH

PRINTED IN THE UNITED STATES OF AMERICA BY
THE HADDON CRAFTSMEN, INC., CAMDEN, N. J.

Preface

THIS study of Morris Plan and other industrial banking companies as agencies of consumer instalment credit is the fourth of a series dealing with the important institutions that participate in the instalment financing of consumers. Other studies included in the series cover personal finance companies, sales finance companies, the personal loan departments of commercial banks, and government agencies of consumer instalment credit (the Federal Housing Administration and the Electric Home and Farm Authority). All of these studies were undertaken in conjunction with the investigation of consumer instalment finance, inaugurated in 1938 by the National Bureau of Economic Research as the initial phase of a broad program of financial research under grants from the Association of Reserve City Bankers and the Rockefeller Foundation.

The industrial banking company cannot be described or analyzed easily. Although it engages in a number of consumer financing activities, some of its operations are not immediately associated with consumer credit. This type of financing agency may be classified, however, in terms of certain distinguishing operating features, and thus an industrial banking company may be defined as an institution which specializes in consumer instalment financing and obtains part of its working funds from customer deposits, the sale of investment certificates of small denominations, or both. A firm of this type organizes the savings of one group of customers as a supply fund out of which it extends loans to another group of customers. The two customer groups served are drawn

largely from the wage-earning and salaried classes, so that the industrial banking company functions as an intermediary between the savings and credit needs of these classes.

In the preparation of the present study, we have gathered data from many sources. From this information Dr. Saulnier has created an institutional picture that is detailed in content yet characterized by the perspective of an outside observer. Dr. Saulnier also collaborated in preparing our studies on consumer financing activities and credit practices of personal finance companies and commercial banks, and thus obtained an insight into the mechanism of consumer instalment financing which has been of great value to this study.

We welcome the opportunity to acknowledge our indebtedness to many firms and their officers for providing materials for our use and for imparting to us an accurate understanding of the techniques and problems of the business. We are also indebted for special information to The Morris Plan Corporation of America, the Morris Plan Bankers Association, and the American Industrial Bankers Association. We were supplied with samples of loan applications by two large Morris Plan banks and by eight industrial banking companies that are members of the American Industrial Bankers Association. The Federal Deposit Insurance Corporation generously aided us by furnishing comprehensive tabulations covering the earnings, expenses, assets and liabilities of the 71 industrial banking companies whose deposits are insured by the Corporation. The banking departments of the several states cooperated in answering numerous letters of inquiry regarding the status of industrial banking under their jurisdiction and also furnished information regarding legislation affecting the operations of industrial banking companies. Although the help of all of the above was invaluable in the preparation of this study, the organizations are, of course, in no sense responsible for the findings presented herein.

Dr. Saulnier has been assisted in the preparation of this volume by various members of the financial research staff.

Ralph Wood, formerly of the staff, made the initial exploration of available materials.

Pauline Arkus assisted in the preparation of statistical tabulations and aided in writing many sections of the text.

David Durand made the analysis of risk factors affecting industrial lending contained in Chapter 6.

The editing of the first draft of this study was done by Bettina Sinclair, the final editing for publication by Elizabeth Todd, and Dorothy Wescott guided the material through the press. The manuscript has benefited greatly by their careful work.

RALPH A. YOUNG

Director, Financial Research Program

September 1940

Author's Acknowledgments

MANY individuals and a number of private and public agencies have cooperated generously in the preparation of this volume. J. P. Christianson, Treasurer of The Morris Plan Corporation of America, advised me on many occasions and made available certain data which form an important part of the study's statistical basis. Richard Stout and his associates in the Morris Plan Bankers Association consulted with me on certain aspects of Morris Plan lending operations. I am especially grateful to T. C. Boushall of the Morris Plan Bank of Virginia and to C. T. Miller of the Morris Plan Bank of New York for having provided important statistical materials.

Throughout the entire study, the American Industrial Bankers Association has rendered invaluable assistance. Myron R. Bone, Executive Secretary of the Association, has generously advised me on many aspects of the activities of industrial banking companies, and with W. E. Yeager, Chairman of the Statistical Committee of the Association, has given me access to a large body of data on industrial banking company operations. Also, I have benefited greatly from the cooperation and wise counsel of many individual members of the Association.

I am also personally indebted to Donald S. Thompson of the Federal Deposit Insurance Corporation for advising me regarding the use of special tabulations covering insured industrial banking companies. Rolf Nugent of the Russell Sage Foundation and Margaret Grobben of the Consumer Credit Institute of America have been very helpful at many stages of the work.

I am deeply indebted to Ralph A. Young, Director of the Financial Research Program of the National Bureau of Economic Research, under whose general supervision this volume was prepared. The initial exploratory work of the study done under Dr. Young's direction by Ralph A. Wood, formerly of the staff of the Financial Research Program, provided me with a well organized body of data indispensable to subsequent stages of the work.

Grateful acknowledgment is made to the members of the staff of the National Bureau of Economic Research who assisted me in my work, particularly to Pauline Arkus who aided in the statistical tabulations and in planning and writing the text, and to David Durand who made the analysis of credit risk presented in Chapter 6. To Bettina Sinclair who did all the editorial work on the first draft of this manuscript, to Elizabeth Todd who edited the final version for publication, and to Dorothy Wescott who guided the manuscript through the press, I owe special thanks.

RAYMOND J. SAULNIER,
Financial Research Staff
(National Bureau of Economic Research)
and
Barnard College, Columbia University

Table of Contents

List of Tables

FINANCIAL RESEARCH PROGRAM OF THE
NATIONAL BUREAU OF ECONOMIC RESEARCH

Studies in Consumer Instalment Financing:
Number Four

Summary Survey

THE industrial banking company, which in many respects resembles other institutions engaged in financing consumers, is most readily identified by its unique combination of loan and savings functions. This characteristic has been adopted as the basis for the definition of such companies that is used in this study: they are regarded as all institutions which extend consumer loans, repayable on an instalment basis, and obtain at least part of their working funds from the acceptance of deposits or the sale of investment certificates. It is not feasible to use legal status as the basis for definition, because the laws governing industrial banking companies are often indefinite, sometimes conflicting. Nor are corporate titles a sufficient basis for identification; many of the companies use the words "Morris Plan" in their titles, but an increasing number are not affiliated with the Morris Plan system.

NATURE AND SCOPE OF INDUSTRIAL LENDING

Industrial lending began in the United States in 1910 with the formation of the Fidelity Savings and Trust Company at Norfolk, Virginia. Established by Arthur J. Morris, it marked the beginning of a Morris Plan system which at the end of 1937 comprised 94 banks and companies operating in 119 cities. Growth was rapid between 1911 and 1917; it was retarded after this country's entry into the World War, but was resumed in the period 1921-30 and again, to some extent, after 1933. Half of the 25 extra-city branches now operating were opened between 1925 and 1930. The Industrial Finance Corporation and its subsidiaries played an important part in this program of expansion. It was formed in 1914 to aid

expansion of the Morris Plan system, and at the end of 1937 it had a controlling stock interest in 15 companies and minority interests in 50 others. In addition to having indirect ownership of some local banks and companies the Industrial Finance Corporation engaged in real estate and time-sales financing through subsidiaries most of which are now inactive. Its Morris Plan Insurance Society, formed in 1917 to write personal loan insurance, has been markedly successful. Other systems of industrial banking companies were established concurrently with the Morris Plan system, but with the exception of two groups organized in 1930 these are now dissolved, their surviving units operating independently.

An indication of the quantitative importance of industrial banking companies is provided by the estimate that there were 410 in operation at the close of 1938, extending between $370,000,000 and $425,000,000 in credit during that year. The scope of industrial lending is further indicated by the estimate that the services of these companies were used by approximately 1,500,000 persons during 1938.

LEGAL STATUS

Since it did not fit into any of the usual categories of corporations, the first industrial banking company was granted a general charter as a Virginia corporation. To some extent this uncertain status exists even now, but in 31 states special statutory provisions have been made for this type of agency. In a few states, even in those that have made special provisions for industrial banking companies, these institutions operate under regular bank charters; in other states they conduct their business under special sections of the small loan law.

Most industrial lending laws prescribe the steps that must be taken before a charter can be issued, stipulate minimum capital requirements and give the charter-granting authority

the right to refuse an application if, in its opinion, the "convenience and advantage of the community" would not be served by the establishment of the proposed company.

Almost all state laws give industrial banking companies extensive lending privileges. Regulations as to the maximum size of note, rarely set at less than $1000, are generally much more liberal than small loan law limitations. Restrictions, when they exist, are usually limitations on, or outright denials of, the right to make real estate loans; there are also maturity regulations, and restrictions on the type of investment securities that can be held as assets.

Sections of industrial loan statutes pertaining to maximum rate of charge apply only to cash loans; except in Indiana the sales-financing activities of industrial banking companies are virtually unregulated. In general, statutes permit loans to be discounted at from 6 to 8 percent. Other charges usually permitted are a credit investigation fee, frequently not to be collected unless the loan is made, a fee for the provision of group life insurance and fees for the preparation of necessary documents. Many laws also provide for delinquency fees, and stipulate maximum and minimum total charges.

Most industrial banking company statutes permit either the acceptance of deposits or the sale of investment certificates, thus enabling companies to acquire loanable funds. Deposits, when "hypothecated," and certificates of investment, when sold on an instalment basis, are often used as collateral security for a loan made simultaneously with the opening of the savings account, although most laws state that when this is done the two transactions are to be considered as separate and distinct. Thus while the loan-repayment and certificate-purchase periods may be equal in length, and while the fully-paid certificate may be used to retire the loan at maturity, the form of the contract separates the two transactions and considers the loan as paid in full

in one payment. This arrangement makes it possible to regard the rate of discount as the annual effective rate of interest, whereas the effective rate is approximately twice the rate of discount on a loan formally repaid in equal instalments.

Other features of state statutes concern branch banking, dividend payments and reserves to be held against accounts receivable, deposits and unhypothecated investment certificates. Examinations and reports to supervisory authorities are also provided for by law, and legislation makes certain companies eligible for membership in the Federal Reserve System and for insurance of deposits under the Federal Deposit Insurance Corporation. In recent years proposals for a uniform industrial banking law have been under consideration.

FINANCIAL STRUCTURE

In having the greatest proportion of their assets in consumer loans and discounts industrial banking companies are notably different from commercial banks; but their major reliance on deposits and investment certificates as a source of funds distinguishes them from other agencies of consumer instalment credit. Savings deposits in institutions with deposits insured by the Federal Deposit Insurance Corporation have shown a tendency to increase in average size, rising from $189 in 1934 to $357 in 1938.

For their relatively insignificant proportion of funds obtained through bank loans industrial banking companies pay rates varying from 2½ to 6 per cent; the rates paid for funds raised through deposits and the sale of investment certificates range mainly from 2 to 4 percent, though as a rule, funds obtained through the sale of certificates prove more costly than funds obtained through savings deposits. Data on insured industrial banking companies indicate that the average

interest paid on deposits has tended to decline somewhat since 1935.

SERVICES AND CHARGES

The present diversification of industrial banking company business is in marked contrast to the earlier practice of these firms. Originally they dealt almost exclusively in comaker loans, and while this type of lending is still important in their business nearly all of the companies now make single-name loans, and most firms make loans on collateral security. Also, many have developed a substantial proportion of sales finance business, developed either through dealer contacts or by appeals made directly to individuals. Commercial lending, too, has grown considerably in importance; at the end of 1938 nearly 12 percent of the total loans and discounts of insured industrial banking companies were "commercial and industrial loans" made to businessmen on a non-instalment basis. Comaker and single-name loans now provide about 50 percent of the volume of all loans, collateral loans roughly 10 percent and sales finance paper from 15 to 20 percent; the remainder is mainly in loans on real estate, loans insured by the Federal Housing Administration, and commercial loans.

The greater liberality of the laws governing them enables industrial banking companies to make larger loans than personal finance companies. Their market, however, is limited mainly to persons with annual incomes of $3000 or less, and thus few of them make many very large loans. Reports by members of the American Industrial Bankers Association show average loan sizes ranging mainly from $175 to $210. Data on 10 relatively large Morris Plan companies show that the average size of loan fell from $271 in 1929 to $228 in 1933, rose to $317 in 1937 and fell again to $288 in 1938. Cash loans made by industrial banking

companies may run for as short a period as 3 months but usually they are for 12 or 15 months. On sales financing business maturities are similar to those offered by other agencies, contracts ranging from 12 to 18 months for most goods, longer for the more expensive commodities.

Competitive conditions have resulted in customer rates about equal to those offered by commercial bank personal loan departments and sales finance companies, rates that are in many instances lower than the legal maximum. Loan costs are customarily quoted as a rate of discount plus a charge for credit investigation, and the discount rate usually varies according to the size of the loan and often also according to the type of security. These variations, in addition to those dependent on company practice and local conditions, make it very difficult to generalize about typical charges. Rates may be as low as 3 1/3 percent discount, plus a credit investigation charge of 50 cents per $100, or as high as 6 or 8 percent discount plus charges. On loans repayable in equal monthly instalments over a 12-month period, the effective rate of interest on average unpaid balances may be calculated as approximately double the rate at which the loan is discounted.

Most industrial banking companies attempt to offer their customers saving as well as lending services. In those states where existing legislation gives such firms the status of banks they are able to offer complete banking facilities, but the majority of industrial banking companies receive savings and deposit funds through the sale of investment certificates.

OPERATING METHODS AND COLLECTION EXPERIENCE

Although all the standard advertising techniques—direct mail, newspaper, radio, and billboard—are used by industrial banking companies, the bulk of their loan volume is obtained

through repeat borrowing and through the recommendations of old customers. Sales financing, if conducted in volume, is necessarily developed through dealer contacts; some banks, however, have developed business by arranging to finance accounts receivable originated by retailers, and many companies finance consumer purchases directly.

Office organization varies according to the size of the firm, 300 loan accounts per employee being regarded as a rough standard of operating efficiency. Loan applications are received and investigated in a manner typical of all consumer credit agencies. In small offices all loans may be passed by one person; in larger institutions it is common practice for a loan committee to review applications. The proportion of rejections varies widely but as a rule it is probably about 25 percent of all loan applications received.

Losses are consistently low, when expressed as a percentage of total credit extended, but they represent an important part of the total expenses of operating an office. During the period 1929-38 the net charge-offs of 10 relatively large Morris Plan companies were consistently less than 1 percent of total loan volume, being highest in 1933, lowest in 1935; during the same period year-end outstandings on delinquent loans ranged from 4.4 percent of total loans outstanding at the end of 1932 to 1.2 percent at the end of 1937. For the entire group of insured industrial banking companies net charge-offs, in percent of year-end outstandings, fell from 1.3 in 1934 to 0.1 in 1936, rising somewhat in 1937 and 1938; on assets other than loans, however, their net losses rose from 1.9 percent of security holdings at the end of 1934 to 5.5 in 1937, and fell considerably in 1938. On the whole these insured industrial banking companies had lower net losses on loans than did comparable commercial banks; on assets other than loans there was no consistent relationship, in the years 1934-38, between the two types of institutions.

CREDIT RISK

An important consideration in consumer instalment lending is the relative degrees of risk involved in various types of loans and various classes of customers. The present study of risk factors is based on a sample of 1,322 accepted loan applications, submitted by 2 large Morris Plan and 8 other industrial banking companies. The cooperating institutions were asked to provide random samples of about the same number of "good" and "bad" loans made over approximately the same period—the former defined as loans that paid out without collection difficulty, the latter as loans that ended in charge-off or legal action for recovery. Since the cases studied refer to credits actually extended, and experience thereon, the findings are relevant only to actual borrowers and not to the much larger group of potential customers.

Analysis of these samples reveals that certain personal characteristics of borrowers are significantly related to collection experience. Thus credit experience seems to be better on loans made to older borrowers than on those made to younger borrowers; women borrowers appear to be better credit risks than men; borrowers who have resided in the same city for a considerable period of time seem to have better records than those with shorter durations of residence. Marital status and number of dependents, on the other hand, do not appear to be significantly related to credit experience. It should be noted again, however, that these findings refer to successful loan applicants and that the results are more reflective of the care with which certain borrower characteristics are taken into account by loan officers than of the risk inherent in a particular class of potential borrowers.

The study reveals also that borrowers from professional and certain clerical occupations, and those employed in public service industries, have better-than-average credit records; borrowers from the miscellaneous transportation industries

prove to have a considerably worse-than-average record of loan performance. Credit experience is better on loans to persons engaged in an occupation for a long period of time than on those to borrowers with shorter durations of occupational attachment.

Financial characteristics of borrowers that appear to be associated with better-than-average credit experience are the possession of a bank account, of life insurance or the ownership of real estate. A borrower's income and the ratio of the amount of a borrower's note to his income do not prove to be significant, doubtless because these factors were adequately taken into account in the original selection of risks.

Among the loan characteristics neither size nor maturity appears to be reliably indicative of credit experience, nor does the purpose for which the borrower intends to use his funds. In regard to loan security, however, it is found that notes carrying the names of three or more comakers have a somewhat worse-than-average record.

INCOME, EXPENSES, PROFITS

About three-quarters of the income of industrial banking companies comes from interest and discounts on loans; fees, charges and commissions amount to from 10 to 15 percent of gross income. Interest and dividends on securities seldom amount to more than 5 percent of gross income. Data on insured industrial banking companies reveal that income from interest and discounts on loans, plus fees and other charges, declined from $9.38 per $100 of average loan account in 1935 to $8.73 in 1938.

The main items of expense incurred by these companies are salaries and wages, and interest paid on deposits and certificates. The former accounts for between 30 and 40 percent, the latter for about 20 percent of gross expenses. Data on insured institutions show that, like income from

loans, current operating expenses (not including charge-offs and losses on the sale of assets) have declined over the period 1935 to 1938, falling from $7.14 per $100 of average loan account in 1935 to $6.42 in 1938.

An indication of the profitability of industrial banking companies is provided by the ratio of net profits to total equity account. For Morris Plan companies this figure averaged about 10 percent during the years 1922-38. Insured industrial banking companies have shown a consistently better earnings record than insured commercial banks, despite the fact that the current operating expenses of the former, when expressed per $100 of total assets, are well over twice as high as those of the commercial banks.

COMPETITIVE AND COOPERATIVE RELATIONS

The competitive situation of industrial banking companies is unique in that the diversification of their activities brings them into direct contact with all types of consumer credit agencies. In making cash loans they compete with small loan companies, credit unions and personal loan departments of commercial banks, and in financing retail instalment sales they compete with commercial banks and sales finance companies. Morris Plan companies are so located as not to compete with one another, but there is a substantial degree of competition between Morris Plan and other industrial banking companies. The recent tendency of sales finance companies to enter the cash loan field brings a new element of competition into the market. Sales finance companies have effected this diversification of their activities by taking out licenses under small loan statutes or by incorporating or qualifying offices as industrial banking companies.

Another relatively recent development in the competitive situation is the extension of commercial loans by industrial banking companies, especially the larger ones, an activity

which, like the acceptance of deposits, brings them again in competition with commercial banks. At the end of 1938 nearly 12 percent of the total loans and discounts of insured industrial banking companies were classified as commercial loans.

Measures of the extent to which there is overlapping of the markets served by these various agencies are difficult to make, but it appears that in regard to cash loans the industrial banking company market is much closer in character to that of the commercial bank personal loan department than it is to the market served by the personal finance company. The relative closeness of competition between industrial banking companies and commercial banks is indicated also by the fact that their loan charges are very nearly the same, while in many cases the charges of industrial banking companies are substantially lower than small loan company rates. Competition with sales finance companies is largely in the automobile field, which accounts for about 75 percent of the retail instalment paper purchased by industrial banking companies. This competition is not very significant, however, for the volume of retail sales financing conducted by industrial banking companies represents less than 5 percent of the total volume of this type of paper handled by all agencies combined.

Cooperative relations among industrial banking companies are effected through two associations—the American Industrial Bankers Association and the Morris Plan Bankers Association—both of which perform the usual trade association functions.

1

Nature and Scope of Industrial Lending

THE field of consumer credit described as "industrial lending" has no fixed limits, and the institutions it encompasses —here called industrial banking companies—operate under a wide variety of names.[1] The initial problem, then, is to formulate a definition which will describe the agencies and at the same time distinguish them from others operating, in some respects, along similar lines. For the purposes of the present study, an industrial banking company is held to be an institution which extends consumer loans repayable on an instalment basis, and obtains at least part of its working funds from the acceptance of deposits or the sale of investment certificates. This definition will be adhered to throughout the discussion, and since it may appear to some readers too arbitrary or too restrictive, and to others too comprehensive or too indefinite, it is advisable to summarize the considerations which have governed its adoption.

THE PROBLEM OF DEFINITION

It is impossible to mark off the field of industrial lending simply by including in it only those agencies which call themselves "industrial banks." Such a procedure would exclude many companies which because of legal restrictions cannot employ the term "bank" in their corporate titles.

[1] In addition to "industrial bank," the names most frequently encountered are "industrial loan company," "industrial savings and loan company," "finance and thrift company" and "discount company."

Nor would the presence of the term "Morris Plan" in the title of an institution be a sufficient criterion. All banking companies in the Morris Plan system—which will be described below—come within the scope of the present study, but that system does not include a growing number of agencies which perform similar functions though they are entirely unconnected with this group of companies. Moreover, there are a few firms which are affiliated with the Morris Plan system, in the sense that they have paid the requisite general franchise fee to The Morris Plan Corporation of America for the right to do business as a Morris Plan institution in a certain specified territory, yet do not exercise the privilege of using the name "Morris Plan" in their corporate titles.

Even less satisfactory than the title of a firm, as a basis for a definition of an industrial banking company, is its legal status. As will be shown more fully in Chapter 2, the laws under which such companies operate vary markedly from one state to another. In some states, for example, companies engaged in industrial lending are chartered as state banks, in others they operate under the law which applies to small loan companies. A large number of states have provided special statutes for industrial banking companies. Some laws expressly forbid the inclusion in the firm name of the word "bank," and also prohibit the taking of deposits.

Thus within the field designated as "industrial lending" there is a wide assortment of institutions, ranging from firms which are "banks" in every sense of the word and differ from commercial banks only in that they deal principally in consumer instalment loans, to agencies which are almost indistinguishable from personal finance companies.

Since neither terminology nor legal status constitutes a workable criterion of an industrial banking company, it is only from a functional point of view that an institution can

be classified as belonging to this separate and distinct group of consumer credit agencies. In other words, its inclusion in this category depends not on its name or on the legal conditions under which it operates, but on the sources of its working funds and the character of its lending activities.

Industrial banking companies have two main functions: they act on the one hand as savings or thrift institutions and on the other as consumer lending agencies. The first of these functions is the best identifying characteristic, for such companies have traditionally emphasized their services as thrift institutions. Where the law under which they operate denies them the deposit-taking privilege, they resort to the sale of what are called instalment or investment certificates. These, in practice, are generally cashable on demand and always, of course, carry a rate of interest or return for the company's use of the funds. It is the thrift or savings feature which distinguishes industrial banking companies from both personal finance companies and sales finance companies, but it is the lending feature which sets them apart from other banking institutions, for the assets of the industrial banking company are invested predominantly in loans of relatively small size, made largely to individuals for consumption purposes and generally repayable in regular periodic instalments.

It is possible, therefore, to regard industrial banking companies as a group of firms which acquire part of their working capital through the taking of deposits or the sale of instalment or investment certificates, and use their funds primarily by granting loans to consumers repayable on an instalment basis. As has already been noted, however, the group is far from homogeneous, and under the pressure of competition the agencies which go to make it up tend to expand their operations in all directions in order to obtain additional business.

SYSTEMS OF INDUSTRIAL BANKING COMPANIES

Industrial lending has grown to its present importance over a period of approximately thirty years, during which time a number of organizations of varying degrees of stability have acted as promotional agencies in the establishment of this type of institution. A large proportion of the firms now in existence were established as parts of a system of companies, and many currently independent units owe their inception and growth mainly to the promoters of group systems.

The Morris Plan System

The most important system, with regard to both quantitative importance and continuity of existence, is the Morris Plan group. The first of the Morris Plan companies, the Fidelity Savings and Trust Company, was established in 1910 by Arthur J. Morris at Norfolk, Virginia. The new institution proposed to lend money to persons employed in industry (hence the name "industrial" loan), on the security of the borrower's income and the endorsement of two or more comakers; this policy is commonly expressed as a willingness to lend on "character and earning power." It also proposed to acquire some of its working funds by selling investment certificates which might be paid for, if the purchasers desired, on an instalment basis. This scheme, while unusual in the United States, had much in common with the program of certain institutions in Europe, notably the Schulze-Delitzsch, Raiffeisen and Luzzatti banks. In 1911 Mr. Morris copyrighted the "Morris Plan," and initiated an active program of expansion aimed at the establishment of Morris Plan companies in large cities throughout the country.[2]

[2] Subsequent legal decisions denied the right to sole ownership of this type of lending to any person or corporation See Louis N Robinson, "The Morris Plan" in *American Economic Review*, vol 21, no. 2 (June 1931) pp 227-29, for a discussion of the litigation involved.

A measure of the rapidity with which this movement spread is available only in a record of the opening dates of companies now in existence.[3] Of the 94 companies (exclusive of branches) functioning at present, 71 were established in the seven-year period 1911-17. During this period companies were started in such large cities as Atlanta, Baltimore, New York, St. Louis, Albany, Cleveland, Boston, Minneapolis, San Francisco, Philadelphia and Detroit, as well as in smaller cities. After 1917 the system continued to expand, although more slowly. The growth of the Morris Plan system appears to have been affected considerably by domestic and international conditions. The development was gradual until the outbreak of the war in 1914; then the system expanded rapidly until the United States' entrance into the conflict. Of the companies now in existence few were formed in the immediate postwar period, but between 1921 and 1930 there was a steady rise. None of the present companies was established in 1931 or 1932, and only a few from 1933 to 1938. A number of the participating companies have opened branches in other cities; this development occurred especially in the period 1925-30, when 13 of the 25 branches now in existence were formed.

Efforts to establish more Morris Plan banks and companies are apparently continuing, for a recent report discusses the preparation of a new franchise and operating contract, and expresses the hope that the formation of new companies may result from this move.[4] At the present time 14 of the 94 Morris Plan banks and companies do not make use of the term Morris Plan in their titles, and at least one large company, the Personal Loan and Savings Bank in Chicago, has dropped out of the system altogether.

The methods employed in the extension of the Morris

[3] *Official Directory of Morris Plan Banks and Companies* (1938), issued by the Morris Plan Bankers Association, Washington, D. C.

[4] Industrial Finance Corporation, *Annual Report to Stockholders*, for the year ended January 31, 1936, p. 3.

Plan system were at first relatively simple. Mr. Morris and his associates made contacts with outstanding business and civic leaders in the various cities, formed a corporation under the legal conditions most nearly applicable to this particular type of institution, sold stock in the company and served in an advisory capacity in regard to techniques of organization and operation. After a time a more highly systematized scheme of expansion was worked out, through the Industrial Finance Corporation.

In 1912 Mr. Morris had formed the Fidelity Corporation of America, with an authorized capital of $300,000, and by 1914 this corporation had established 9 Morris Plan companies in southern states. Its assets were taken over by the Industrial Finance Corporation, formed in the latter part of 1914 with an authorized capital of $7,000,000 and a subscribed capital of $1,500,000. The function of the Industrial Finance Corporation was to present and explain the Morris Plan in each city for which it contemplated a new company, to enlist the active interest of prominent citizens, to organize and train the local staff and to furnish necessary accounting records and information. It subscribed for 25 percent of the capital stock of the local company and received in return a cash fee of $10 for each share of the total stock; in addition, of course, it participated in the earnings of the company to the amount of its paid-up stockholdings.

At the present time the Industrial Finance Corporation is the parent body of a complicated corporate system. It has direct control, through stockownership, of The Morris Plan Corporation of America, the Industrial Acceptance Corporation, the Industrial Realty Shares, Inc., and the North American Funding Corporation; it has indirect control, through The Morris Plan Corporation of America, of a number of Morris Plan banks and companies and The Morris Plan Insurance Society.

The Morris Plan Corporation of America is the most im-

portant of these subsidiary companies. When it was formed in 1925 it acquired the Industrial Finance Corporation's rights, patents and interests in the extension of the Morris Plan, and it is now the licensor of all existing Morris Plan banks and companies. In some of them it owns stock, either directly or indirectly through a wholly owned subsidiary, the Industrial Bancshares Corporation; in its annual report to stockholders for 1938 The Morris Plan Corporation of America stated that it owned approximately one-fourth of the total outstanding stock of Morris Plan banks and companies. This does not mean that it controls one-fourth of all these organizations. In 1937, according to its report for that year, it held controlling stock interest (directly or indirectly) in 15 companies, including those in New York, Philadelphia, Richmond, Washington, D. C. and Boston, and minority stock interest in 50 others; there were in that year 29 Morris Plan banks and companies, exclusive of branches, with which it was not connected through stock-ownership.

The Morris Plan Corporation of America, and its wholly owned subsidiary, Industrial Bancshares Corporation, derive their income mainly from dividends on stockholdings in Morris Plan banks and companies. Out of a total income for 1938 of $486,212, this source provided $441,788, and $36,962 came from "services to Morris Plan Banks and Companies."[5] Presumably the latter income arises largely from the general franchise fees paid by local banks and companies, and from payments for auditing services.

Industrial Bancshares Corporation was formed in 1927 as the Morris Plan Shares Corporation; its present title was adopted in 1929. When this corporation was organized the Industrial Finance Corporation had large liabilities which had been incurred in order to finance investments in Morris

[5] The Morris Plan Corporation of America, *Annual Report to Stockholders*, for the year ended December 31, 1938.

Plan banks and companies. The new corporation took over these stockholdings, making payment for them out of the proceeds of a sale of 6 percent bonds maturing in 1947 and by delivering to the Industrial Finance Corporation its entire authorized capital stock. At the present time $2,917,500 of these bonds are outstanding.[6]

In addition to holding a large interest in Morris Plan banks and companies, the Industrial Finance Corporation has branched out into three other fields, mortgage financing, time-sales financing and industrial loan insurance. In 1926 it organized a company, under the name of General Bond and Share Corporation, which acquired the assets and business of the Puritan Corporation and the Realty Acceptance Corporation. The Puritan Corporation had been engaged in underwriting first mortgage real estate bonds, the Realty Acceptance Corporation in the financing of second mortgages. These two companies were taken over through an exchange of stock which resulted in the Industrial Finance Corporation's acquisition of more than 50 percent of the common stock of General Bond and Share. The latter was in turn absorbed in 1930 by Industrial Realty Shares, Inc., a Delaware corporation organized for this purpose and also controlled by Industrial Finance Corporation.

In 1928 another company, the North American Funding Corporation, was organized, this too controlled by the Industrial Finance Corporation. The aim of the North American Funding Corporation was to extend amortized first mortgage loans on residential property to the customers of Morris Plan banks and companies. The corporation was to lend up to 75 percent of the appraised value of the property, and it could then pledge up to 60 percent of the value of the property as security for its bonds; the balance of the mortgage was purchased as a junior lien by the Realty Acceptance Corporation.

[6] *Ibid*, for the year ended December 31, 1939.

The operations of the North American Funding Corporation were financially successful until the collapse of real estate values in 1929-30. In the following period the corporation gradually liquidated its holdings at substantial loss, and suspended new financing. By 1933 it was repurchasing at prices "materially below their par value"[7] the $3,000,000 of bonds issued in connection with its financing. This process was financed in part by a loan of $525,000 from the Reconstruction Finance Corporation, which was fully repaid during 1935, and in part through "the conversion of mortgages into Home Owners Loan Corporation bonds and the subsequent sale of these bonds."[8] The fact that during the year 1937 the North American Funding Corporation wrote off $617,713 in assets[9] provides some indication of the loss sustained by the company as a result of its venture into real estate financing. By the end of 1938 the corporation had reduced its bonds outstanding to $195,900, and its assets amounted to only about $650,000, of which some $425,000 was the equity of the Industrial Finance Corporation.[10]

It may be observed that the same annual report of the Industrial Finance Corporation, which notes this reduced position of the real estate financing subsidiary, states that the relation of net earnings to capital, surplus and undivided profits for 86 identical Morris Plan banks and companies had increased from 11.5 percent in 1929 to 13.0 percent in 1938. These strikingly divergent records, both based on financing activities in the general field of consumer credit, may be reconciled by the fact that Morris Plan banks and companies participated only slightly in this program of real estate financing.

The second direction in which the Industrial Finance Cor-

[7] Industrial Finance Corporation, *Annual Report to Stockholders,* for the year ended January 31, 1933, p. 3.
[8] *Ibid.,* for the year ended January 31, 1931, p 3.
[9] *Ibid.,* for the year ended January 31, 1938, p. 4.
[10] *Ibid.,* for the year ended January 31, 1939, p. 4.

poration expanded its consumer financing activities was in the discounting of time-sales contracts In 1924 the Industrial Acceptance Corporation was formed, and this company, which was controlled through stockownership by the Industrial Finance Corporation, took over the sales financing business formerly handled by the Automobile Division of the parent corporation. The Automobile Division had concentrated mainly on financing sales of Studebaker cars, and for some time this continued to be true of the new company. From May 21, 1919, to May 1, 1928, the Studebaker Corporation had formal arrangements, first with the Industrial Finance Corporation and later with its subsidiary, the Industrial Acceptance Corporation, providing for wholesale and retail financing of sales,[11] but in its annual report for the year ended January 31, 1929, the Industrial Finance Corporation stated that its subsidiary had diversified its activities and was no longer "dependent upon one contract with a single manufacturer." During the year 1928 Industrial Acceptance Corporation acquired from General Electric Company the capital stock of General Contract Purchase Corporation and its affiliates. The general program of sales financing was described as follows in the annual report of Industrial Finance Corporation for the year ended January 31, 1930: "Whenever Industrial Finance Corporation owns a controlling interest in a Morris Plan Bank or Company, local subsidiaries of those companies carry on the business of installment financing, rediscounting their receivables where necessary with Industrial Acceptance Corporation . . . Emphasis is being laid throughout our whole system on handling the financing for the sale of General Electric refrigerators and other products under a national arrangement with the General Electric Company."

During this same period a most pretentious plan was an-

[11] Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) (76th Congress, 1st Session, House Document No. 468) p. 817.

nounced, in which Industrial Acceptance Corporation was to participate. Under this program Industrial Finance Corporation was to organize "a system of banks covering all the important cities of this country, to extend to the public every form of industrial banking service."[12] This system of industrial banking companies was to operate through 22 regional companies; it provided for the inclusion of companies currently controlled by Industrial Finance Corporation and for the organization of many more so-called "member banks." The plan was mentioned again in the report for the year ended January 31, 1930, but was never actually put into operation.

Even the relatively modest Industrial Acceptance Corporation failed to withstand the post-1929 years. In 1931 arrangements were completed with Commercial Credit Company whereby that corporation was to take over the instalment financing business previously transacted by Industrial Acceptance Corporation in cities where no controlled Morris Plan company was located. This meant, of course, a very drastic reduction in the field of operations of the Industrial Acceptance Corporation. At the end of 1933 the acceptance business was being liquidated and no new business was being sought. A plan for the Industrial Acceptance Corporation to go into the small loan business, presumably on a large chain basis, was announced in 1935, but no further developments were forthcoming and by 1939 the company was virtually inactive.[13]

A far more successful venture of the Industrial Finance Corporation has been its connection with the insuring of loans extended by Morris Plan industrial banking companies. This business was developed through the formation, in 1917, of The Morris Plan Insurance Society, controlled through

[12] Industrial Finance Corporation, *Annual Report to Stockholders*, for the year ended January 31, 1929, pp. 4-5.
[13] *Ibid.*, for the year ended January 31, 1939, p. 5.

stockownership by The Morris Plan Corporation of America. The purpose of the society is to offer the group life insurance service commonly associated with the extension of credit to consumers. Although the real estate and time-sales financing activities initiated by Industrial Finance Corporation failed to withstand depression strains, the record shows that The Morris Plan Insurance Society, deriving its business from the local industrial banking companies, has remained remarkably stable. In fact, it has enjoyed a considerable rise in business, and rather steady and substantial earnings. In the twenty years from 1917 to 1937 its policies mounted in number from 1,432 to 250,765. At present the society is licensed to do business in 28 states, including New York.

Other Systems

During the period when Industrial Finance Corporation was setting up Morris Plan banks and companies, other organizations, and also individuals, were establishing similar systems. One of these, the Wimsett System, extended from the east coast to Honolulu; the others were for the most part regional in their operations. Thus the Hood System companies were confined largely to North Carolina, the Morgan Plan companies to Alabama and other southern states, the Peoples Finance and Thrift companies mainly to California, the Community Savings and Loan companies to Pennsylvania, the Thrift companies also to Pennsylvania, and the Citizens System companies to the midwestern states. None of these systems has survived to the present time, however. Many of the component companies failed, and some were merged with other companies. Those still in existence now operate independently of any system but many of these have retained the name of the system under which they were originally formed, although there is no formal relationship between units.

The methods by which these companies were set up

varied only in detail. In general, it appears that the organizers were interested mainly in promotional gains, and withdrew after the companies were established. They would merely introduce the plan in a chosen city, help raise capital, train the staff of the new company and supply certain materials for the keeping of operating records. In a few cases the promoters retained stockownership, but generally they were compensated by a flat fee, or a fee related to the volume of loans made by the new company in the first year or two of operation. Where the promotional group received stock the local company often reserved the right to buy it back at a stipulated price, and where this procedure was followed a commission was received on the whole stock flotation.

In recent years two other systems of industrial banking companies have been organized along somewhat different lines. One of these, Southeastern Industrial Bankers, Inc., was founded in 1930 and now operates 14 companies in Maryland, the District of Columbia, Virginia and West Virginia. The parent organization has control of these companies, through stockownership, and supervises their operation.[14] Capital for the enterprises is raised by Southeastern Investment Company. The second of the new systems, Industrial Finance and Thrift Corporation, was established in Louisiana in 1930 as "an outgrowth and expansion of the business of the D. M. White Company, Inc., of Jackson, Mississippi."[15] At the present time there are 10 White System companies, located in Louisiana, Mississippi and Tennessee. They act in their own localities as agents of Industrial Finance and Thrift Corporation, endorsing and guaranteeing collection on consumer loans extended by that organization. These loans are used by the latter corporation

[14] Southeastern Industrial Bankers, Inc., *Annual Report,* March 31, 1931.

[15] Booklet printed by Industrial Finance and Thrift Corporation, New Orleans, Louisiana, providing information on its activities.

as security for its collateral trust notes, which are sold to raise working funds. Both of these networks are very close-knit, a characteristic that distinguishes them from the earlier systems, many of which were rather loosely organized.

QUANTITATIVE IMPORTANCE OF INDUSTRIAL BANKING COMPANY CREDIT

In view of the difficulties involved in the definition of an industrial banking company, the number of such companies which operate in the United States at the present time can be only estimated. One way of arriving at such an estimate is to divide all the firms which come within the above-determined definition into two major types: Morris Plan institutions and those that are outside the Morris Plan system. There are now 94 Morris Plan banks and companies and 25 branches, excluding intra-city branches. Massachusetts, with 16 companies (exclusive of branches), has more than any other state; it is followed by New York, North Carolina and Ohio, with 8 each; the remaining 54 companies are scattered through 27 states and the District of Columbia.

The companies outside the Morris Plan system, since they are far more numerous and less homogeneous, are considerably more difficult to count. It was estimated in 1935 that "approximately 750 industrial banking institutions, other than commercial banks with time-payment departments, are now operating in this country."[16] This estimate, however, appears to be too high.

At the end of 1938 the American Industrial Bankers Association had 137 members in continental United States, and its list of prospective members totaled 397. It should be remembered, however, that the "reputable industrial banks and loan companies" which are acceptable for membership

[16] Myron R Bone, "Dividends from the A.I.B.A." in *American Industrial Banker*, vol. 1, no. 4 (December 1935) p. 16.

in this organization are defined as any "incorporated company 51 per cent or more of whose loan business is in the lending of money and discounting of contracts repayable in weekly, semi-monthly or monthly installments . . .,"[17] whereas in the present study an industrial banking company is regarded as an institution which not only lends funds to consumers for repayment on an instalment basis but also, at least in part, obtains its working funds from the acceptance of deposits or the sale of certificates. Of the present and prospective members of the American Industrial Bankers Association there are, according to our estimates, only 317 that conform with the definition used here.[18] With only a single exception, this organization does not include members of the Morris Plan Bankers Association. Thus, with the addition of the other 93 Morris Plan banks and companies, there are 410 institutions which, in the usage of the present study, may be regarded as industrial banking companies.

It is not possible to derive from any single source an estimate of the volume of credit extended by these 410 companies, or of the amount of their outstandings at any particular time. Various sets of incomplete data may be combined, however, to suggest the quantitative importance of credit extended by this type of agency.

Questionnaire reports are available from 50 industrial banking companies outside the Morris Plan system, showing that on December 31, 1938, the average outstandings per company were $401,000. If this average is multiplied by 316, a result of $126,716,000 is arrived at, representing the 1938 year-end outstandings of the total estimated number of in-

17 "A I B A. By-Laws Approved as Amended" in *American Industrial Banker,* vol. 2, no 4 (December 1936) p. 13.

18 This number is based in part on an elimination of those companies on the lists which, judging from name alone, do not appear to be of the type here defined as industrial banking companies, and in part on correspondence with individuals whose general experience enables them to classify the firms according to this criterion.

dustrial banking companies not within the Morris Plan system. For the same date The Morris Plan Corporation of America has estimated the outstandings of all Morris Plan banks and companies at $122,295,000. Thus the total outstandings of all industrial banking companies on December 31, 1938, may be put at approximately $250,000,000.

From these figures it is possible to derive an estimate of the volume of credit extended during the year. For industrial banking companies the ratio of loans granted to loans outstanding is probably between 1.5 and 1.7. Data from the American Industrial Bankers Association indicate that in 1936 loans granted were 1.7 times loans outstanding, whereas in 1937 the ratio was 1.5. The difference is difficult to account for, but probably it is attributable not so much to a lengthening of maturities as to the fact that the companies reporting in the two years were not identical. On the basis of the 1.5 ratio the total loans granted during 1938 by all industrial banking companies may be computed at $373,516,500, with Morris Plan banks and companies accounting for $183,442,500 of this amount. If the ratio of turnover is considered to be 1.7, the total of loans granted during 1938 is raised to $423,318,700. Thus it may be concluded that aggregate loans granted by industrial banking companies in 1938 ranged between $370,000,000 and $425,000,000; these figures include $10,500,000 of loans made during 1938 that were insured under Title I of the National Housing Act.

The foregoing estimates are obviously only rough approximations, but more precise data are too fragmentary to be of use in indicating totals. Thus data from the Federal Deposit Insurance Corporation indicate that the 71 insured industrial banking companies, distributed throughout the country, had about $101,015,000 outstanding in loans and discounts at the end of 1938; these figures, however, pertain only to insured deposit-taking companies, and deposit-taking privileges are granted industrial banking companies in only a few states.

Again, 15 states issue reports on the volume of outstandings of industrial banking companies, and these reports, covering about 150 companies, both Morris Plan and others, show approximately $132,000,000 in outstandings at the end of 1938; the reports are not all as of the same date, however,[19] nor are they equally complete in coverage, and no reports are available from states in which industrial banking firms are incorporated under the general corporation laws and do not operate under special industrial banking legislation.

Another measure of the quantitative importance of credit extended by industrial banking companies is provided by the number of individual borrowers served by this group of credit agencies. On the basis of the foregoing estimates of total loan volume in 1938, and on the assumption that the loans averaged $250, the total number of borrowers served during that year may be put at between 1,480,000 and 1,700,000. For many companies the assumed average size of loan—$250—would be too high, and for most offices loan volume includes some proportion of renewed loans. In a computation of the number of borrowers served these two factors would tend to counteract one another, but it cannot be determined from available evidence whether they are in this case exactly counterbalancing. It would seem reasonably certain, however, that industrial banking companies extended their credit to approximately 1,500,000 persons in the year 1938.

[19] Data for Nebraska are available as of June 30, 1937; for Indiana and Virginia, as of December 31, 1937, for Florida, New Hampshire, Utah and West Virginia, as of June 30, 1938; for Connecticut, as of September 30, 1938; for Maine, Maryland, Michigan, New York, North Carolina, Ohio and Rhode Island, as of December 31, 1938.

2

Legal Status[1]

WHEN the first industrial banking company was organized in Virginia in 1910, there was no specific law in that state providing for the incorporation of this type of company. Since it failed to fit into any of the usual categories of corporations, the new firm was granted a general charter as a Virginia corporation. Although in some states this indefinite and unsatisfactory legal status has continued to the present day, most states where industrial banking companies have been established in any considerable number now have special provisions governing such institutions. There is still, however, no more than a general similarity among the various state statutes.

It is true that some industrial banking companies have been incorporated under general banking statutes, thus attaining the status of banks, but this has not often occurred. The main reason why special legislation has been necessary is the fact that in most states the general banking statutes are not drafted in such a way as to apply to the extension of personal instalment loans, which is the primary activity of industrial banking companies.[2] And since the

[1] A list of state statutes applying to industrial banking companies is given in the Appendix The present chapter is based on an examination of these statutes and on correspondence with state bank supervisory authorities and officials of industrial banking companies

[2] Only in 10 states do the general banking statutes make some special provision for personal instalment loans: Arizona, Delaware, Maine, Michigan, New Jersey, New York, North Carolina, Ohio, South Carolina and Virginia See National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit*, by John M. Chapman and Associates (1940) Chapter 2

companies, not having bank status, could not raise loanable funds by accepting deposits, another peculiarity, not in conformance with general banking law, developed in their operating procedure: the issuance of instalment investment certificates.

Thus the legislation that pertains specifically to industrial lending usually contains provisions regarding loans payable in instalments, the issuance of instalment investment certificates, and the imposition of various charges and fines characteristic of the consumer lending procedure. While industrial loan laws contain many other provisions, it is these special features that distinguish them from general banking statutes. It should not be assumed, however, that such special legislation deals effectively with all the important problems involved in industrial banking activities. Most of these laws make no mention, for example, of time-sales financing, which has come to be of considerable importance to many industrial banking companies. A notable exception in this respect is the Indiana law regulating sales financing, which applies as forcefully to industrial banking companies as to any other type of credit agency.

At the present time 31 states[3] have some special statutory provision for industrial banking companies; in the remaining 17 states[4] no such provisions have been made. The first group includes not only those states which have "industrial bank," "industrial loan company" or "industrial loan and investment" acts, but those in which legal provision for sub-

[3] Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Indiana, Iowa, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, New York, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Texas, Utah, Virginia, Washington, West Virginia and Wisconsin. In the District of Columbia industrial loan companies are subject to a special law passed by the national legislature, but this act does not apply to industrial banks in the District that operate on bank charters.

[4] Alabama, Georgia, Idaho, Illinois, Kansas, Louisiana, Mississippi, Nevada, New Hampshire, New Jersey, New Mexico, North Dakota, Oklahoma, South Dakota, Tennessee, Vermont and Wyoming.

stantially the same type of operation is made under the general banking laws, as in Ohio, or under other statutes, as in Iowa.

In the 17 states that have no special provisions for industrial banking companies, these concerns must operate under other laws. In Louisiana, Mississippi, Oklahoma and Tennessee they are at present chartered under the general corporation laws. In Georgia one Morris Plan institution is chartered as a state bank, while another Morris Plan company and several other industrial banking companies operate under an amendment to the Building and Loan Association Act. In Illinois, too, several different types of legislation affect industrial banking companies; here some institutions operate under state banking charters, others under the state small loan act, and still others under the general corporation law.

The following pages are devoted to a comparative analysis of the main features of the industrial banking laws now in force. The purpose of the discussion is not to present a complete summary of industrial banking law but rather to show, by reference to the most significant provisions in a few state laws, how the organization and operation of a consumer credit agency of this type are affected by legal conditions.

REGULATIONS REGARDING ORGANIZATION

Most of the state industrial banking laws contain provisions prescribing in some detail what steps must be taken before an industrial banking company can be granted a corporate charter. The New York law, for example, provides that five or more persons may form a corporation to be known as an industrial bank by submitting an organization certificate to the superintendent of banks and having it approved by that office. The certificate must state the name of the proposed bank, the place where its business is to be transacted,

the amount of capital and the number of shares to be issued, the address of each incorporator and the number of shares he subscribes to, the term of existence (which may be perpetual), and the names and addresses of the directors, numbering at least five, who are to serve the corporation until the first meeting of stockholders. An authorization certificate is issued by the superintendent of banks if he is satisfied that all the requirements, especially those relating to capitalization, have been met.

This general pattern is characteristic of the majority of state laws, although in some, as in that of West Virginia, the initial agreement of incorporation must be submitted to the secretary of state who, in turn, forwards it to the commissioner of banking for approval. In some cases incorporation fees are charged by the incorporating authority. Most laws state that the authorizing officer must investigate the character and fitness of the incorporators.

In the procedure governing initial organization a feature with an important bearing on local competitive conditions is that which charges the charter-granting authority with the duty of considering the application in the light of the "convenience and advantage of the community." Thus in the state of Ohio the superintendent of banking is instructed to refuse approval if the establishment of an industrial banking company, called in Ohio law a "special plan bank," will not, in his opinion, serve the best interests of the public. In Pennsylvania the Consumer Discount Act, under which companies engaged in industrial lending may operate, stipulates that before a license can be issued by the secretary of banking it must be determined whether such action would promote the "convenience and advantage of the community." In the state of Washington a somewhat different situation prevails, in that the supervisor of banking is required to decide whether the resources available in the immediate sur-

roundings of the proposed company are such as to give reasonable promise of adequate support for its existence.

The intent of such provisions is, of course, to limit the number of companies permitted, either by license or by charter, to do business in a given community, and the ultimate purpose is to curb the development of severely competitive conditions. There are no data available, however, on the interesting question of the number of applications rejected on this ground. In at least one state, Michigan, the law prohibits the incorporation of any new industrial banks. This provision of the Michigan Financial Institutions Act has been in effect since April 30, 1929.

In some states the procedure of incorporation is very simple, doubtless because few companies have applied for charters or licenses. In the state of Montana, for example, the application is submitted to the governor of the state and approval is granted by him. Nevertheless, a severe restriction on industrial banking company activity is embodied in the Montana law, for it stipulates that no company may be organized to do business in a city with less than 20,000 inhabitants, a condition which limits companies to two cities.

MINIMUM CAPITAL REQUIREMENTS

Another feature commonly found in state laws governing industrial banking companies—and one which has doubtless served to keep down the number of companies seeking organization privileges—is the provision concerning minimum capital requirements. As in general banking law, the requirement is often stated in relation to the population of the city in which the principal office of the business is to be located. Thus in Massachusetts the law stipulates that no company may operate with a capital of less than $50,000; the minimum is raised to $100,000 in the communities with a population of between 100,000 and 300,000, and to $200,000 in

cities with a population of over 300,000. The Massachusetts law further stipulates that the minimum capital must be fully paid in before business is begun. Some state laws permit operations to begin when 50 percent of the capital has been paid in, the remainder to be paid in monthly instalments, each amounting to 10 percent of the entire capital.

Other states have much less detailed provisions on this point. In Indiana, Chapter XXI of the Financial Institutions Act governing industrial banking and investment companies merely stipulates that the capital stock of any company operating under its provisions shall be no less than $50,000, the entire sum to be fully paid in before the company opens for business. Companies incorporated and engaged in business before the passage of this law, which went into effect on July 1, 1935, were allowed three years in which to meet the minimum capital requirement.

Provisions with regard to required capital vary in stringency from one state to another. For a company seeking to operate in a city with a population of 75,000, for example, the laws of Arizona, Connecticut, North Carolina and Ohio would insist upon a minimum capitalization of $100,000. On the other hand licensees in Kentucky or Pennsylvania would be permitted to function in a city of this size with as little as $25,000. The minimum set in other states ranges from $30,000 to $50,000. Then there are some states, including Wisconsin, which have no special provision for minimum capital requirements, and others, including Missouri, which merely refer to the general corporation law. Companies operating as state banks or under small loan laws are, of course, required to meet the special provisions embodied in these statutes.

Closely related to minimum capital requirements are the regulations, found in a number of state laws, governing the types of capital stock which may be issued and the conditions upon which the amount of such stock may be increased or

decreased. Many states, for instance, sanction the issuance of only one class of stock. These provisions need not be elaborated upon, however, since they have a relatively minor effect upon the business operations of industrial banking companies.

LENDING PRIVILEGES AND RESTRICTIONS

Types of Loans and Investments Permitted

State laws vary considerably in the extent to which they regulate the lending operations of industrial banking companies, although none of them fails to exercise some degree of authority on this point. In a few instances the law confers a blanket right to lend money. An example of such legislation is the California Industrial Loan Act, which permits companies to lend money "on personal security or otherwise." A similar situation obtains under the Virginia Industrial Loan Association Law, which allows companies to lend money to any person, firm or corporation, the loan to be repaid in periodic instalments and secured by the obligations of the same party or by any other security. A much more detailed form of regulation is that embodied in the Indiana Industrial Loan and Investment Act, which gives companies the following lending privileges: first, to discount, purchase or otherwise acquire notes, bills and acceptances or other choses in action; and second, to lend on individual credit or the security of comakers, on personal endorsement, on the mortgage of real or personal property, and on the mortgage or pledge of choses in action.

Several of the states, including Massachusetts, prohibit loans secured by real estate, and in some, real estate loans are permitted but subject to definite restrictions. Thus in Indiana a mortgage must be a first lien, maturing in no more than 5 years, on improved real estate located within 50 miles of the principal office of the lender. It is provided also that

the loan shall not be in excess of 60 percent of the fair cash value of the property as verified by written endorsement, and that the total of real estate loans shall not exceed 25 percent of the total of a company's paid-in and unimpaired capital and outstanding certificates of investment or indebtedness. These qualifications do not apply to mortgages taken as additional security for loans otherwise authorized in the Indiana act. Two states, Indiana and Maine, explicitly permit FHA Title I real estate improvement loans. Other laws make no specific allowance in this respect, but the lending privileges they confer are broad enough to permit industrial banking companies to take advantage of the insurance protection supplied by the federal government.

Regulations governing the types of investment securities which industrial banking companies are permitted to hold as assets are scarcely important enough to warrant a detailed review, because only a relatively small proportion of industrial banking company assets is invested in securities. In general, such companies are restricted to investment in securities eligible for purchase by savings banks within the state.

Many states expressly forbid industrial banking companies to make loans secured by the company's own stock, on the ground that the use of such security would be tantamount to a reduction of the company's capital. Also, it is not unusual to find a law forbidding loans to directors, officers or employees of the company, except when such loans are approved by vote of a majority of the board of trustees. In Indiana, loans to directors cannot be made on any condition.

Regulation of Loan Maturities

Almost every law that governs industrial lending contains a provision concerning the maximum maturity or contract length of cash loans The laws of Kentucky, Missouri, Montana, Texas and Utah limit the maturity of loans to one

year; the limitation in Pennsylvania and West Virginia is two years. In Virginia, on the other hand, maximum length of contract is set at ten years; it is possible that despite this extremely liberal provision in Virginia the supervisory authorities would not allow companies to extend an ordinary industrial loan over such a long period. Arizona, Arkansas, Delaware, Florida, Indiana, Massachusetts, Ohio, South Carolina and Wisconsin set no maximum for maturities; in other states laws are so written as to permit maximum maturities varying according to the type of loan. Thus in New York industrial loans are limited to 15 months except when secured by real estate mortgages; for loans so secured no maximum maturity is fixed. In Rhode Island real estate mortgage loans may extend as long as five years, while other loans are limited to one year. Indiana establishes a maximum maturity of 24 months on comaker loans and five years on loans secured by real estate mortgages. In California loans are restricted to one year, but companies are allowed to discount conditional sales contracts for as long as two years. Colorado's law is unique in that its maturity regulation applies only to loans of less than $500; loans of this amount may not extend beyond one year but there is apparently no limitation on larger loans.

Regulations Regarding Size of Loans

Where industrial banking companies operate under small loan laws they are subject to the $300 maximum which applies to nearly all personal finance companies. In general, however, special industrial lending statutes have raised this limit to allow the companies a far greater freedom in lending.

The most complete and detailed set of regulations governing the maximum size of industrial loans is to be found in the law of New York State. Here such loans are restricted to $5000 when secured by bonds, notes or instalment certificates of investment. In addition, companies are allowed to

discount or purchase notes, bills of exchange or other obligations in amounts up to one-tenth of the capital stock and surplus of the lending company, with the following exceptions: (a) the one-tenth limitation does not apply to investments in bonds or other obligations of the United States or of New York State or of any political subdivision of New York State; (b) investment in the obligations of foreign nations, railroad corporations, states other than New York, municipal corporations other than those of New York State, and corporations subject to the jurisdiction of the New York State Public Service Commission may not exceed 25 percent of the company's capital stock, surplus and undivided profits; (c) loans may equal but not exceed 25 percent of the capital stock, surplus and undivided profits of a company if the obligations are secured by "drafts or bills of exchange drawn in good faith against actually existing values, or upon commercial or business paper actually owned by the person negotiating the same,"[5] and are endorsed without limitation; (d) loans may equal but not exceed 25 percent of capital, surplus and undivided profits if they are secured by marketable securities having an ascertained market value at least 15 percent greater than the amount of the loan secured; (e) an industrial lending company may not take or hold more than 10 percent of the capital stock of another banking or insurance corporation as collateral security. The New York law also contains further limitations concerning real estate loans.

Other state laws are far less detailed than that of New York. Arizona, Pennsylvania and Wisconsin merely restrict industrial banking companies to loans of $1000 or less. In some states the maximum is set at $2000, as in Kentucky, or at $5000, as in Colorado and Rhode Island. In all other states which have industrial banking legislation the provi-

[5] New York State Banking Department, Bulletin No. 3, *Industrial Banks*, Article VII, Section 294, 8, b.

sions are stated entirely in terms of a percentage, varying from 2 to 20 percent, of paid-in capital and surplus, and exceptions are noted for government securities, notes, bills of exchange, acceptances and loans secured by marketable securities. The most restrictive of all laws is that of the District of Columbia, which limits cash loans to \$200.[6] Except in this instance it would appear that the regulations concerning the maximum size of loans are not so stringent as to hamper seriously the operations of industrial banking companies.

As was pointed out at the opening of this chapter, industrial banking law, almost without exception, imposes no restrictions upon sales financing transactions. Thus while the cash loan limit may be rather low in a few jurisdictions, companies are usually free to transact sales finance business in whatever amounts and on whatever terms they desire.

MAXIMUM LEGAL CHARGES[7]

Industrial loan laws usually regulate rates of charge on cash loans by setting a maximum per annum rate of discount, delinquency fee and investigation or service fee. In addition they commonly provided that the investigation fee may not be charged unless the loan is actually made. In some states, however, the regulation is much more general. For example, the Colorado and Wisconsin laws stipulate a flat 10 percent discount and make no provision for other fees or charges. In Missouri, North Carolina, Virginia and West Virginia the law states that industrial banking companies may charge the

[6] This applies, of course, only to companies operating under non-banking charters. One large industrial banking company located in Washington, D C. operates on a national bank charter.

[7] The rate provisions of the Indiana law have not been included in this discussion because rates in that state are set at the discretion of the Department of Financial Institutions after a public hearing. The Financial Institutions Law governing industrial lending does not provide a legal rate schedule.

usury rate, plus an investigation fee. The latter, which in Missouri is chargeable only if the loan is made, is generally $1 for each $50 borrowed, or fraction thereof.

The Consumer Discount Act of Pennsylvania sets up a more detailed structure of maximum legal charges. This law permits licensees to discount contracts for one year at 6 percent, and to charge an investigation fee of $1 per $50 on loans up to $500 and of $1 per $100 on any remaining portion of loans up to $1000. The Pennsylvania act also sets a maximum investigation fee of $3 on loans of $25 or less and of $6 on loans exceeding $25. No fee may be charged, however, unless the loan is actually made. In addition, a company operating under this act is permitted to charge a delinquency fee of 1½ percent per month of the amount in arrears, although such charge may not be greater than 25 cents.

In general, the discounts allowed by industrial loan legislation tend to be from 6 to 8 percent where additional charges are allowed. In Massachusetts, where no provision is made for other charges, companies may discount at 12 percent on the first $500 of a loan and at 9 percent on the excess. Delinquency fees, when specially provided for in state laws, are generally set at 5 percent of the delinquent payment. In some instances an absolute maximum is also set; thus in New York the maximum delinquency fee is 50 cents on loans of less than $50 and $5 on loans of $50 and over. This law also stipulates, as do the Florida and Minnesota laws, that the delinquency fee is not to be cumulated. Other provisions designed to protect the borrower from excessive exactions for delinquency are incorporated in several enactments. The Washington law states that the fee is not chargeable unless the loan has been in default for one week or more. The Oregon law, which allows a fee of 5 percent of the delinquent payment per week, stipulates that after the delinquent instalment has been paid all subsequent instalments must be

extended for the length of time for which the legal fee was paid; moreover, the charge cannot be levied for more than four weeks on any one instalment. In the Rhode Island law delinquency fees may not be imposed for more than ten consecutive instalments, and the maximum fine is set by the amount of the delinquent payment.

When investigation fees are specifically provided for in laws governing industrial lending they are usually set at from 2 to 2½ percent of the amount of the loan, with varying provisions as to absolute maximum. An interesting feature of the New York law is the prohibition of a second investigation fee if a loan is made again within the next three months to the same borrower. Most state laws which mention investigation fees expressly forbid the charging of such a fee unless the loan is made. The legislation of Florida, North Carolina and Virginia, and the proposed law of Kansas, do not touch upon the matter of investigation fees.

In Arizona, Connecticut, Florida, Oregon, Pennsylvania and Washington industrial banking companies are permitted to collect, in addition to other charges, special fees to cover the costs actually incurred in the recording and filing of documents involved in the extension of a loan. Only Pennsylvania, however, makes special provision for a fee to cover the cost of loan insurance. Presumably other states permit such charges under the general statement that fees may be charged to meet any actual costs incurred in connection with a loan.

DEPOSITS

It has already been emphasized that in many states industrial banking companies are prohibited from accepting deposits. Some laws, however, now grant this privilege, either in whole or in part. Thus in both New York and Virginia industrial banking companies are empowered to accept deposits and to

issue as evidence thereof bonds, notes, certificates or other token of indebtedness. The New York and Virginia laws provide also that industrial banking companies may accept deposits repayable by check or other similar order. The latter privilege may be exercised in New York if the amount of the capital stock of the company is not less than the amount of the capital stock which other types of banks in communities of the same size would be required to have in order to exercise this privilege. Other states, including Arizona, Florida, Michigan, North Carolina and Ohio, make provision for the acceptance of time deposits, but for the most part forbid the taking of demand deposits or commercial accounts. Where a company has a state or national bank charter it is, of course, permitted to do a general deposit business.

All industrial banking companies in states which make provision for the acceptance of deposits by companies incorporated under their statutes, and all institutions operating on state or national bank charters, are eligible for membership in the Federal Deposit Insurance Corporation. Other industrial banking companies operate under laws which provide for the issuance of certificates of investment, and though these companies are in effect receiving deposits they are not eligible to subscribe to stock of the FDIC.

At the end of 1938 there were 71 FDIC-insured industrial banking companies, located in the following states: Alabama, Delaware, District of Columbia, Florida, Georgia, Illinois, Kentucky, Maryland, Michigan, Missouri, New York, North Carolina, Ohio, Pennsylvania, Tennessee and Virginia. It is interesting to note that the Industrial Bank Act of North Carolina, as originally written, described deposit funds as certificates of indebtedness or investment. The law was later amended to read that industrial banks might "solicit, receive and accept money or its equivalent on deposit both in savings accounts and upon certificates of deposit." Almost all

the industrial banking companies in North Carolina are now members of the FDIC.

SALE OF INVESTMENT CERTIFICATES

From their inception a distinguishing characteristic of industrial banking companies has been their practice of selling certificates of indebtedness or investment. Since companies of this type were not in the beginning allowed to accept deposits, the sale of such certificates was generally resorted to as a means of obtaining loanable funds. The practice is still followed in states which forbid the acceptance of deposits, and a few companies use this device even though they are granted the deposit-taking privilege.

It is not only as a means of obtaining funds, however, but also as a lending procedure that the sale of certificates has proved an important part of industrial banking company practice. Personal instalment loans, not provided for in most general banking legislation, can be extended by industrial banking companies in connection with the sale of investment certificates, to be paid for by the borrower in periodic payments. A certificate thus used as collateral security for a loan is referred to as "hypothecated"; one used as an instrument of savings is "unhypothecated." In the present state of the law these two types of transactions are closely related; most industrial banking legislation permits companies to sell certificates of investment, whether or not they are to be used as collateral for a loan.

In most state laws the instalment sale of an hypothecated investment certificate is viewed as a transaction separate and distinct from the extension of the loan. The purpose of this fiction is to eliminate all formal difference between a loan extended by an industrial banking company and a straight loan repayable in its entirety at the date of maturity. Thus it is possible for the former to be regarded as conforming

with the statutes governing maximum legal interest rates, in spite of the fact that the effective rate of interest on a loan paid off in instalments is greater than it is on a loan paid at maturity in one payment, assuming that both loans are discounted at the same rate for the same period of time; on a regularly declining balance the effective rate is roughly twice the rate of discount. In the Ohio law relating to "special plan banks" it is explicitly recognized that the borrower who repays in regular instalments pays a higher effective rate of interest than he would if the loan were repayable in one sum at maturity. Under this law a commercial bank, if it takes out a license as a "special plan bank," may accept regular instalment payments on a loan and "avail itself" of a rate of interest which is higher than the 8 percent legal maximum.[8]

The form of the provision concerning certificates of indebtedness or investment is fairly uniform in the majority of state enactments. In the North Carolina law, which may be considered representative in this respect, it is stated that an industrial bank is permitted to "sell or offer for sale its secured or unsecured evidences or certificates of indebtedness, or investment, and to receive from investors therein or purchasers thereof payments therefor in installments or otherwise, with or without an allowance of interest upon such payments, whether such evidence or certificates of indebtedness or of investment be hypothecated for a loan or not, and to enter into contracts in the nature of a pledge or otherwise with such investors or purchasers with regard to such evidences or certificates of indebtedness, or of investment; and no such transaction shall in any way be construed to affect the rate of interest on such loans."[9]

The separation of the two transactions, the granting of the loan and the instalment sale of the certificate of indebt-

[8] *Banking Laws of Ohio, Annotated,* 1937, General Code, sect. 710-180.
[9] *Banking Laws of North Carolina,* Article 10, sect 225 (f) 2.

edness, is made explicit also in the Connecticut law, which stipulates that the payments on the certificates are "not to be construed as part payment of such loan."[10] In the proposed Kansas law payments on certificates are distinguished from the loan transaction by a clause which reads: "Such investment certificate and the subscription therefor, shall be construed to be a separate, distinct, and independent transaction and contract from that of the loan, and the payments on the investment certificate shall not be included, or considered when computing the interest charged on the loan, and such payments on the investment certificate shall not be construed, deemed, or taken to be payments made on account of the principal and interest on the loan secured thereby."[11]

Although in some states, notably Massachusetts, the law permits industrial banking companies to make instalment loans without recourse to the hypothecation device, there are companies in these states which still cling to the practice of hypothecating instalment payments on certificates and then charging this entire deposit against the face of the note at maturity.

Where special legislation has been enacted to cover certificates of investment the law usually states whether or not such certificates may bear interest. Although some companies have at times paid interest even when the certificate was hypothecated, thus effecting a reduction in the cost of the loan to the borrower, payments of this sort are not general practice. Interest is always paid, however, when the certificate is not hypothecated. In many cases the laws provide withdrawal features, whereby the certificate becomes for all practical purposes the same as a time deposit. The statutes of California and Utah expressly demand, however, that each

[10] *Laws Relating to State Banks, Trust Companies, Etc*, 1937, sect. 4034 (6).
[11] Kansas Legislature, Session of 1939, *House Bill 410*, sect. 3 (e). There is an identical passage in the Senate Bill No. 323.

certificate be stamped with the statement, "This is not a certificate of deposit."

In Maine and in Washington the law stipulates that when a certificate is sold at the same time that a loan is made, the price of the former may not exceed its actual face value In Massachusetts and Missouri the aggregate payments required on the certificate may not exceed the face amount of the loan plus the lawful rate of interest and permitted fees. These and similar provisions are designed to protect the borrower from being charged an illegal rate of interest through the instalment certificate device.

RESERVES

Most industrial banking companies maintain reserves against potential losses on their outstanding loans, but in no state except Washington do the industrial banking laws establish standards on this matter. In no state are reserves required against hypothecated deposits. Where industrial banking companies are permitted to take time or demand deposits, however, they are subject to the same requirements as are other banking institutions, in regard to the reserves to be held against these liabilities. In such cases there is considerable similarity in the requirements. The reserve requirement varies among the states but is never less than 5 or more than 10 percent of deposits and outstanding unhypothecated investment certificates. In Michigan and New York, both of which grant extensive powers to industrial banking companies, reserves must be maintained and handled by such companies in the manner prescribed for other state banks.

The distribution of reserves, too, is set by law. The proposed Kansas statute stipulates that half of the 5 percent reserve on unhypothecated deposits and investment certificates is to be held in cash and half in bank deposits; the same regulation applies to state banks. Florida, which stipulates

a 10 percent reserve, requires that three-tenths of it be kept in cash and seven-tenths in marketable securities. Other states make no requirements as to the distribution of the reserve, but many set up standards as to how it shall be invested; bonds of the United States, bonds of the state in which the company is incorporated, marketable securities and deposits in banks located in the same state are the principal uses approved.

DIVIDEND PAYMENTS

Provisions for the payment of dividends are contained in about one-third of the industrial loan laws. These for the most part state that before any dividends may be paid, 10 percent of net profits must be carried to surplus until the latter equals a stated percentage of the paid-up capital stock. It is in the required ratio of surplus to capital stock that the differences among the states stand out clearly. Oregon requires that the ratio be 15 percent, Minnesota 20 percent, California and Washington 25 percent, Florida and Massachusetts 50 percent, and New York 65 percent. In Michigan one-tenth of the net profits of a company must be carried to surplus until the latter equals the amount of common stock capital.

Some laws carry these provisions even further. Washington is unique in its requirement that before a corporation declares a dividend it must set aside a reserve for losses, the amount of such reserve to equal 1 percent of the total outstanding loans and discounts. The statute of this state also prohibits the distribution of unearned interest as a part of the profits. A similar restriction is expressed in the law of West Virginia. In Massachusetts dividends may not exceed the company's total net undivided profits, exclusive of surplus, after deductions for bad-debt losses not otherwise provided for. Bad debts are defined by the law as obligations

owed to the corporation on which interest is due and has been unpaid for six months, but such obligations are not regarded as bad debts if they are well secured and in process of collection.

In the law of Indiana the provision covering dividend payments is expressed somewhat differently from comparable regulations in other states. Semi-annually, on June 30 and December 31, before payment of any dividends, a company operating in Indiana must transfer to its surplus account a credit equal to 5 percent of its net earnings for the preceding six months. This surplus account is to be accumulated until it equals the amount of the capital stock of the company. No company may declare dividends upon its stock in any form unless its capital is unimpaired and unless it has accumulated, and maintained unimpaired, a surplus fund equal to 25 percent of its capital. Dividends may then be declared, though no more frequently than semi-annually. The rate of dividends paid by a company is not to exceed 6 percent of the book value (determined by the banking department) of its shares, until such time as the unimpaired surplus fund of the company equals the amount of its unimpaired capital stock.

BRANCH BANKING

In some states industrial banking companies have grown in size and importance to the point where it has become necessary for the law to stipulate whether or not branch banking is to be permitted. A few of these states have sanctioned the setting up of branches but have at the same time imposed certain limitations upon their establishment and operation.

According to the law of Washington, branches may be established only with the approval of the state superintendent of banking. In Michigan the banking commission must approve the creation of a branch, and it grants such permission

only for branches within the city where the principal office of business is located. New York allows branches within the city of the main office, but only if that city has a population of at least 50,000; it stipulates also that for each branch there must be a capital of at least $100,000. Branches established before June 1937 are, not, however, affected by this section of the New York statute.

Massachusetts allows a wider branch banking system. Here branches may be established not only in the city or town of the principal office but also throughout the county. This provision does not apply to branches established before January 1935. Florida and North Carolina allow branches throughout the state. The branches of industrial banking companies in Florida are not permitted to accept deposits of any type, although the principal office may accept time deposits.

The statute of North Carolina imposes more specific branch capital requirements than do the laws of other states. Here the establishment of a branch in a community with a population of 15,000 or less is permitted only on the condition that the parent bank has paid-in capital of $25,000 for itself and each branch. This requirement is raised to $50,000 when the population of the branch office city is between 15,000 and 25,000, and to $100,000 where the population exceeds 25,000.

In Pennsylvania branch banking as such is not mentioned in the Consumer Discount Act. A statewide branch organization could be developed, however, by qualifying a number of offices to operate under this act. Where companies are chartered as state banks they may, of course, avail themselves of the same branch banking privileges as are afforded state banks. In Pennsylvania an industrial banking company operating on a state bank charter can maintain branches only within the same city.

Aside from any formal system of branches, there are chains

or groups of companies that have been formed through corporate arrangements. About 15 Morris Plan banking companies are controlled through stockownership by The Morris Plan Corporation of America, and some individual industrial banking companies have a controlling stockownership in companies in other cities.

SUPERVISION

The majority of the statutes pertaining to industrial banking companies provide that the state banking department shall exercise supervisory authority over such institutions. There are some variations, however, on this general rule. In California the commissioner of corporations is the supervisor, in Florida authority is vested in the state comptroller, and in Arkansas and a few other states the securities division regulates the activities of the companies.[12] In those states in which industrial banking companies operate under a small loan act or a state bank charter, supervision and examination are carried on in the manner prescribed for other institutions affected by these laws. Some states provide that industrial banking companies be examined according to the procedure for state banks (Florida, Kansas), or for savings banks (Maine).

Examinations vary as to both frequency and thoroughness. In general, state laws require that companies be examined twice a year. In Arkansas the securities division of the banking department may make detailed audits of the business at any time during the year and as often as it deems necessary. The cost of the examination is borne by the banking company, but its amount may not exceed $10 a day. In Indiana the examiners make their own analysis of the value of the loans and arrive at their own figure for the net worth of the

[12] Companies are regulated by the securities division of a state on the ground that the sale of an instalment investment certificate constitutes a security sale.

company. They verify collateral held as security for loans and note whether the ledger cards are in balance. Also, they check to see that proper refunds are being made on prepaid loans.

It has been a frequent practice to list delinquent loans as "slow," "doubtful" or "loss," but this classification has probably been altered in some states in accordance with the agreement entered into in June 1938 by federal bank supervisory agencies. This agreement substituted numerical for descriptive designations, and specified definitions of the various classes. The adoption of the new classification was recommended to state bank supervisory authorities by the Executive Committee of the National Association of Supervisors of State Banks.[13] Examiners also list loans in the hands of attorneys, and charge-offs and recoveries. Detailed questions, sometimes filling several pages, are asked concerning bookkeeping practices and office management, and the company is required to submit a regular balance sheet and a list of the directors' borrowings, endorsements and stockownership.

It should be emphasized, however, that few states provide for an examination which takes account of all the above-mentioned aspects of a company's operations. In some states no examination is made, with the result that company practices are governed merely by whatever degree of competition exists in the community and by a sort of self-policing undertaken by the firms themselves.

Reports on company operations are required in most states, although in this respect too there is no uniformity. Michigan provides that such reports shall be the same as for state banks, and imposes fines on institutions which fail to file them. Utah requires one report annually and special reports on demand. New York stipulates that reports are to be made upon request of the superintendent of banking. The remain-

[13] Federal Deposit Insurance Corporation, *Annual Report*, for the year ended December 31, 1938, pp. 63-64.

ing states require either one or two reports annually; and Connecticut provides that no more than five shall be demanded in any year.

In general, the reports call for balance-sheet and income-statement items. Some insist also upon a detailed account of loans, classified by size and type, and a detailed statement of charge-offs, recoveries and delinquencies.

OTHER FEATURES OF INDUSTRIAL LOAN LAWS

Several state laws confer powers or impose restrictions upon industrial banking companies which have not been covered in the preceding discussion.

Many laws have provisions concerning the amount of stock which must be owned by directors, the minimum varying from $100 in Virginia to $1000 in Massachusetts. Many have requirements as to the directors' residence; in Montana, for example, three-fourths of the directors must be residents of the state. Minnesota goes even further, stipulating that three-fourths of the directors be residents of the principal city in which the company is located.

Not uncommonly restrictions are enforced against the use by any company of the word "bank" or "banking" in its title. Minnesota forbids the use of the word "banking." The statute of Connecticut permits the use of the word "bank" except where it would indicate that the company is a savings or commercial bank. In Washington companies operating under the industrial loan act must have a title ending with "industrial loan company," and in Pennsylvania those operating under the Consumer Discount Act must have a title ending with the words "consumer discount company."

A number of laws have also provisions which restrict the functions of industrial banking companies. In Arizona, Colorado, Florida and Indiana such firms may not act as trustees, and in Michigan they may not be affiliated with any cor-

poration engaged principally in the issue, flotation and underwriting of stocks, bonds, debentures and the like. The Indiana law has an interesting section to the effect that a company shall not engage in any business other than industrial lending except to act as a broker in writing insurance on the life of a borrower as security for a loan.

Other regulations provide for the charge-off of bad debts and the operation of safe deposit departments. The West Virginia statute contains a provision prohibiting a company from making a payment to an outside firm for the right to use any plan of banking. This is an obvious attempt to forestall membership in a system developed along Morris Plan lines.

Finally, many states have special regulations concerning the taxing of industrial banking companies. Four laws, those of California, Florida, Oregon and Washington, stipulate that such companies must be taxed in the same manner as other general corporations. Six other states—Arizona, Connecticut, Indiana, Massachusetts, North Carolina and West Virginia—require that these institutions be taxed as banks.

Within recent years federal legislation has taken special account of industrial banking companies. By the Emergency Banking Act of March 9, 1933, firms under the supervision of state banking departments or the comptroller of the currency were given the right to rediscount their receivables with the Federal Reserve banks, and the Banking Act of 1935 made such companies eligible for membership in the Federal Reserve System. At the present time 4 companies, located in Illinois, Michigan, North Carolina and Ohio, are members of the Federal Reserve System. With the exception of the bank in North Carolina, these institutions are eligible for membership by virtue of their status as state banks.

Another action of considerable importance to industrial banking companies was taken by the Board of Governors of the Federal Reserve System on August 31, 1938, when the

amended subsection 3 (a) of Regulation L, having to do with interlocking bank directorates, was further amended to forbid any director of a member bank to serve as a director of a "Morris Plan bank or similar institution" after February 1, 1939.[14] On November 7, 1938, another amendment to Regulation L gave member banks until August 1, 1939, to sever such relations, and later the date was still further postponed to June 1, 1940. This revision of Regulation L was made in view of the tendency for industrial banking companies and commercial banks to become increasingly similar in their operations. The new requirement may cause a change in the personnel of many boards of directors of industrial banking companies, since many of these companies have had directors who have also held directorships in member banks. The Clayton Act, however, and amendments thereto, under which these regulations are issued, excepts from its provisions banks not located in, or "contiguous or adjacent" to, the same town or city as the member bank.[15]

UNIFORM LEGISLATION

From the foregoing review of the laws governing the establishment and operation of industrial banking companies, it is evident that even in states which have enabling legislation there are certain legal prohibitions which may be held to hamper the development of these firms. Furthermore, there are other states in which no special provision has been made for the regulation of industrial banking companies. As a result, considerable interest has developed in the formulation of a uniform industrial banking or industrial lending law.

[14] Federal Reserve System, *Twenty-fifth Annual Report of the Board of Governors,* covering operations for the year 1938, p 74.

[15] "Contiguous" has been interpreted as referring to cities, towns or villages whose corporate limits touch at some point, and "adjacent" as referring to places between which there is "substantial competitive interest" although they are not actually contiguous. See *Digest of Rulings of the Board of Governors of the Federal Reserve System to October 1, 1937,* p. 271.

Such a law was proposed in 1936 at the annual convention of the American Industrial Bankers Association, and was adopted by that group with the proviso that it be adapted to meet the special circumstances prevailing in any particular state.

The proposed uniform law defines an industrial loan company as follows: "The term Industrial Loan Company as used in this act refers only to such companies as make a business of lending money, repayable in weekly, semimonthly or monthly instalments, and which may or may not issue to the borrower simultaneously with the loan transaction their own written evidence of debt."[16] The law as drafted provides that a company may not be incorporated by fewer than five persons, and that the amount of capital stock shall be conditional upon the population of the city in which business is to be transacted. Companies in cities with less than 50,000 inhabitants are to have not less than $25,000 in capital, and those in cities with more than 50,000, not less than $50,000. At least 50 percent of the capital must be paid in before the company may open for business, the remainder to be paid in monthly instalments of at least one-tenth until the entire amount has been fully paid. The draft provides also that a company shall be managed by a board of at least five directors, each of whom must subscribe to at least $1000 of capital stock.

Broad powers would be granted to industrial banking companies in the proposed law. In addition to being allowed the general privileges conferred upon corporations, they would be empowered to make loans "secured by real or personal property, or by one or more makers or otherwise, and to deduct interest therefor in advance at a rate not exceeding 8 percent per annum, and to receive weekly, semi-

[16] "Uniform Law is Given Approval" in *American Industrial Banker*, vol. 2, no. 2 (June 1936) pp. 9-10. This definition is obviously much broader than that adopted in this volume for an "industrial banking company."

monthly or monthly payments thereon with or without an allowance or interest on payments."[17] Provisions are made for investigation and delinquency fees, for the issuance of investment certificates, for the establishment of branches throughout the state, and for the discounting or purchase of notes, bills of exchange, acceptances, stocks and bonds, or other choses in action.

The uniform law would prohibit the carrying of demand deposits and the making of loans to employees, directors or officers of a company. It stipulates that no loan may be made to anyone in an amount greater than 10 percent of the company's paid-up capital and surplus. The duration of loans would be limited to two years, except when a board of directors saw fit to increase the length of a contract. Issues of unhypothecated certificates of investment would be restricted to five times the total capital account, and a company would be required to carry a cash reserve equal to 5 percent of its outstanding unhypothecated investment certificates. Finally, the law contains provisions concerning reports to supervisory authorities and payments of dividends.

[17] *Ibid.*, p 9.

3

Financial Structure

INDUSTRIAL banking companies, as has been pointed out, are most effectively differentiated from other consumer credit agencies by reference to the sources of their working funds. As between industrial banking companies and commercial banks, however, a distinction must rest rather upon a comparison of the uses to which these two types of institutions devote their assets. A study of the asset and liability structure of industrial banking companies serves to clarify this aspect of operation, and also provides the basis for an explanation of the profitability record of these companies.

SOURCES OF FUNDS

The financial structures of industrial banking companies have shown a marked change as these companies have matured into established institutions. At the present time, while there is scarcely any real uniformity, there is a considerable degree of similarity, at least within certain groups of companies. For all companies the chief sources of funds are equity account (capital, surplus and undivided profits), deposit and investment certificate accounts, and bank borrowings. These vary in relative importance, however, from one firm to another.

For a study of the evolution of the financial structures of industrial banking companies the best available data are those compiled by The Morris Plan Corporation of America. These data, presented in Table 1, cover the years 1920-37,

TABLE 1

SOURCES OF FUNDS OF REPORTING MORRIS PLAN BANKING COMPANIES, 1920–37, IN PERCENT OF TOTAL ASSETS[a]

Year	*Number of Companies*	*Source of Funds*			*Total Assets*[c]
		Equity Account[b]	Deposits and Certificates	Borrowings and Rediscounts	
1920	87	42.7	31.2	19.9	$ 31,148
1921	85	40.2	38.4	15.1	34,837
.. [d]	..	..			..
1925	98	24.2	62.0	7.7	88,408
. [d]	..		..	.	
1929	107	20.7	63.9	8.9	138,273
1930	103	21.2	66.4	6.5	143,043
1931	105	22.7	66.8	4.3	127,616
1932	100	23.5	68.4	1.1	109,288
1933	97	23.7	68.0	1.5	99,120
1934	95	23.6	67.8	1.8	106,536
1935	95	21.4	69.5	1.4	122,903
1936	93	18.7	71.3	1.6	143,716
1937	91	17.3	72.4	2.5	157,365

[a] Based on year-end data supplied by The Morris Plan Corporation of America. The percentages do not add to 100; the difference represents reserves and miscellaneous liabilities.

[b] Capital, surplus and undivided profits.

[c] In thousands of dollars.

[d] Data for 1922-24 and 1926-28 are not available.

and although the number of companies represented changes from year to year, the coverage of Morris Plan institutions is so complete that the principal tendencies revealed by these figures may be considered reliable. One of the more significant of these trends is the dwindling relative importance of the equity items. In 1920 and 1921 these items accounted for somewhat more than two-fifths of total liabilities. Their relative weight dropped sharply between 1921 and 1925, and by 1929 they contributed little more than one-fifth. In 1937

equity funds amounted to only 17.3 percent of the total assets of the companies covered. Another trend worth noting is the decline in borrowings; in the early 1920's these represented almost one-fifth of total liabilities, whereas in the years 1932-36 they accounted for less than 2 percent, though they rose slightly in 1937.

While both borrowings and equity funds were declining sharply during the years 1920-25, there was a noteworthy increase in the relative importance of time and demand deposits and investment certificates, which rose from 31 to 62 percent in this period. Thereafter the gain was slow but fairly consistent: in 1937 deposits and certificates amounted to almost three-fourths of the total liabilities of the reporting Morris Plan institutions.

Data from other sources cover a shorter period of time, but they lend support to the findings presented in Table 1. Thus the decline in the relative importance of equity funds and borrowings, and the rise in that of time deposits (unhypothecated), are corroborated by figures supplied by the Federal Deposit Insurance Corporation, covering all industrial banking companies insured by that agency in the years 1934-38. These figures, presented in Table 2, show that the equity funds of this group of companies fell from 17 percent of total assets in 1934 to 12 percent in 1938. In dollar volume, however, the equity items rose from $17,517,000 to $20,562,000, an increase due in part to the fact that in 1938 there were 71 insured industrial banking companies whereas in 1934 there were only 60. For this increasing number of companies, borrowings, expressed in percent of total assets, declined in these years from 1.9 to 0.1 percent.

It is to be noted that in the FDIC data time deposits are classified as either unhypothecated or hypothecated. The former, being a clear liability of the company, can properly be considered a source of funds; hypothecated deposits can-

TABLE 2

SOURCES OF FUNDS OF INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, IN PERCENT OF TOTAL ASSETS[a]

Source of Funds	*1934*	*1935*	*1936*	*1937*	*1938*
Equity account[b]	17.1	15.1	13.3	11 6	12 1
Time deposits					
Unhypothecated	56.3	57.7	60.9	60.5	60.0
Hypothecated	18.3	17.6	17 2	18.4	18 2
Demand deposits	1 8	2.2	2 4	3.6	4 7
Borrowings	1 9	1.7	1 0	.9	.1
Number of companies	60	62	63	69	71
Total assets[c]	$102,755	$123,342	$146,129	$175,263	$169,492

[a] Based on year-end data supplied by the Federal Deposit Insurance Corporation. The percentages do not add to 100; the difference represents reserves and miscellaneous liabilities.

[b] Capital, surplus and undivided profits.

[c] In thousands of dollars.

not be so regarded, however, since they represent loan repayments which have not yet been directly applied to the loans themselves. In these data there is, of course, no mention of investment certificates, for all the insured industrial banking companies enjoy the deposit-taking privilege and therefore do not need to sell certificates. From Table 2 it appears that unhypothecated time deposits have been the most important source of funds for these insured institutions; in relation to total assets they amounted to 56 percent in 1934 and rose to 60 percent by 1938. Demand deposits, although they have increased in relative importance, have not been very significant, probably because many states have legal prohibitions against industrial banking companies assuming liabilities of this sort. Supplementary figures on this group of insured companies indicate that the sources of funds were substantially the same, over the period 1934-38, for the larger as for the smaller companies.

Additional data on 64 Morris Plan institutions[1] reveal a current situation similar to that shown in Table 2. They also serve to supplement the data presented in that table, since only 38 of the 71 industrial banking companies admitted to insurance by the FDIC by April 1939 were connected with the Morris Plan. As of December 31, 1938, the equity items of these 64 Morris Plan banks and companies, though comparatively unimportant, were nevertheless far more significant than the borrowings—13.2 percent of total assets as compared with 0.2 percent. In the deposit data on this group of companies there is unfortunately no separation of hypothecated and unhypothecated deposits, demand deposits and investment certificates outstanding. The figure for all these items amounts to 71.8 percent of the total assets —more than five times the figure for equity funds and borrowings combined.

Some state reports provide information concerning industrial banking companies, and data from this source are presented in Table 3, for 1938. They tell much the same story as the figures already cited. In almost all the states represented either investment certificates or time and demand deposits are the most important sources of working funds; borrowings, where reported separately, are relatively slight. Five of these states[2] give data also for 1930 and 1933, again corroborating, for the period 1930-38, the finding that deposits and certificates have tended to rise and borrowings to decline in relative significance as a source of funds for industrial banking companies.

It will be remembered that there are a good many companies which, though they are members of the American

[1] Data obtained from Polk's *Bankers' Encyclopedia* (March 1939 edition) Balance sheets were not available for Morris Plan companies in Iowa, Massachusetts or Minnesota, or for those in the following cities: Kansas City, Los Angeles, Nashville, Tampa, York.

[2] Connecticut, New Hampshire, North Carolina, Rhode Island and West Virginia.

TABLE 3

SOURCES OF FUNDS OF INDUSTRIAL BANKING COMPANIES IN 15 STATES, 1938, IN PERCENT OF TOTAL ASSETS[a]

State	Number of Companies	Source of Funds				Total Assets[c]
		Equity Account	Time and Demand Deposits[b]	Investment Certificates	Borrowings	
Connecticut[d]	12	55.1	.0	33 8	3.2	$ 5,549
Florida[e]	6	28.6	65.5	.0	.2	2,543
Indiana[f]	8	18.5	.0	69.8	5.1	5,033
Maine	1	33 2	.0	62.3	0	491
Maryland	1	15.8	74.1	3 5	.0	2,344
Nebraska[g]	5	21.2	.0	71.6	1 1	1,343
New Hampshire[e]	1	5.1	92.0	0	.0	1,248
New York	15	14.2	78 8	.0	.3	57,726
Michigan	7	11.5	82.0	.0	.0	23,550
North Carolina	33	31.1	.0	60.0	2 4	13,408
Ohio[e]	8	15 9[h]	66 4	.0	.0	20,512
Rhode Island	5	27.0	2	63.3	.1	6,077
Utah[e]	4	54.4	28 0	0	11.0	599
Virginia[f]	19	49.4	1.8	37.4	6 3	4,682
West Virginia[e]	17	53.2	.0	33.2	6.0	5,641

[a] Based on reports of state banking departments. Unless otherwise noted, data are for December 31, 1938 The percentages do not add to 100, the difference represents reserves and miscellaneous liabilities.
[b] Exclusive of hypothecated deposits.
[c] In thousands of dollars.
[d] As of August 30, 1938.
[e] As of June 30, 1938.
[f] As of December 31, 1937.
[g] As of June 30, 1937.
[h] Includes reserves.

Industrial Bankers Association, do not accept deposits or sell investment certificates, and therefore do not conform with the definition of an industrial banking company, as established in this study. The data presented in Table 4 would seem to lend support to the classification used here, for they

TABLE 4

SOURCES OF FUNDS OF INVESTMENT AND NON-INVESTMENT TYPES OF INDUSTRIAL BANKING COMPANIES, 1936, IN PERCENT OF TOTAL ASSETS[a]

Source of Funds	*Investment Companies*	*Non-Investment Companies*
Equity account	*30.4*	*70.1*
Common stock	16 9	46.6
Preferred stock	4.8	13.2
Surplus and undivided profits	8.7	10.3
Borrowings	*9 4*	*20 1*
Long-term debt	0	4 1
Short-term debt[b]	9 4	16.0
Time and demand deposits and investment certificates	*48.7*	*.0*
Number of companies	25	21
Total assets[c]	$10,456	$3,708

[a] Based on year-end data supplied by the American Industrial Bankers Association. The percentages do not add to 100; the difference represents corporate reserves and miscellaneous liabilities.
[b] Includes an unknown amount for accounts payable; this amount, however, is presumably insignificant and approximately the same for both types of companies.
[c] In thousands of dollars.

show quite clearly how the financial structures of companies which derive funds from these sources differ from the structures of non-investment firms. The latter, instead of depending primarily on deposits and investment certificates, draw their funds mainly from equity account and borrowings.

But even though the institutions here defined as industrial banking companies do not, in general, rely on borrowings to any important extent, there are some firms in this category that do make use of bank loans as a source of funds. A number of these firms offer Christmas Club savings plans to their borrowers, and it is not unusual for them to meet seasonal withdrawals of such deposits by borrowing from

banks. Data on the cost of borrowing funds from commercial banks are limited in coverage and refer mainly to relatively small companies. These data indicate, however, that the smaller industrial banking companies borrow from banks at rates varying from 4 to 6 percent; larger companies borrow currently at rates as low as 2½ percent.

A few industrial banking companies are financed in part by the sale of collateral trust receipts. One group of firms operating in the southern states has worked out an arrangement whereby their notes can be pledged, through a rediscount corporation, as security against collateral trust receipts sold by that corporation. The arrangement requires that any pledged note which becomes delinquent shall be withdrawn and replaced by a non-delinquent note. The corporation borrows up to 80 percent of the face value of the collateral and lends to the individual companies. By this financing arrangement it is possible for companies to obtain working funds more economically than they could if they were either to borrow directly from banks or to sell investment certificates.

The rates paid by industrial banking companies as return for investment certificates and deposits have tended to decline in recent years, and are now between 2 and 4 percent. On investment certificates some institutions offer graduated rates, whereby the notes running for the longest period bear the highest rate of return. Companies whose deposits are insured by the FDIC and those that are members of the Federal Reserve System are, of course, governed by the regulations of these agencies as to the maximum return payable on deposits.

The trend of the average rate of interest paid by the larger industrial banking companies on time and savings deposits is roughly indicated in data provided by the FDIC. On total time and savings deposits the average rate of payment fell from $1.95 per $100 in 1935 to $1.50 in 1938. Total deposits,

however, include some that are hypothecated against borrowers' loans, and on these the practice of banks in regard to the payment of interest is not known. If interest rates are computed on total time and savings deposits minus hypothecated accounts, the average rate of payment is found to have fallen from $2.56 per $100 in 1935 to $1 95 in 1938. Since some of the reporting banks do pay interest on hypothecated deposit accounts it may be concluded that in these years the actual average rate on total deposits was between the two pairs stated. This downward trend is corroborated by data on insured commercial banks that are not members of the Federal Reserve System. The average rate of interest paid on time and savings deposits by this group of banks fell from $2.28 per $100 of total time and savings deposits in 1935 to $1.82 in 1938.[3]

On time deposits some companies offer an interest schedule graduated according to the amount held. The Morris Plan Bank of Virginia, for example, put into effect on December 1, 1939, a plan whereby 2½ percent is paid on amounts from $10 to $2500, 1½ percent on amounts from $2501 to $5000, and 1 percent on amounts from $5001 to $7500; no interest is paid on that amount of a time deposit that is in excess of $7500, and no interest is paid on deposits of any bank, firm or corporation operated for profit.[4] The rate of 2½ percent had previously been paid on amounts between $10 and $5000, and the bank states that 94.1 percent of its regular savings customers were not affected by the change.[5] The inference that this statement carries concerning the average size of savings deposits is supported by year-end data, for the period 1934-38, on industrial banking

[3] Federal Deposit Insurance Corporation, *Annual Report,* for the year ended December 31, 1938, p. 57.

[4] Morris Plan Bank of Virginia, *Annual Report to the Stockholders,* for the year 1939, p. 6.

[5] *Ibid.,* pp. 6-7.

companies insured by the FDIC.[6] In these companies savings accounts averaged $189 in 1934, $233 in 1935, $275 in 1936, $323 in 1937 and $357 in 1938. The average savings account in the Morris Plan Bank of Virginia amounted to $511 at the end of 1939.

USES OF FUNDS

Industrial banking companies, like personal finance and sales finance companies, keep the greatest part of their assets in loans and discounts, that is, in the outstanding consumer receivables which arise from their lending operations. For insured industrial banking firms, as can be seen from Table 5, loans and discounts account for roughly two-thirds to three-fourths or more of total assets, regardless of the company's size. Securities and cash balances account for most of the remainder, in proportions that vary somewhat, though apparently without consistency, as between companies of different sizes. At the end of 1934 insured industrial banking companies held, on the average, a relatively high proportion of their total assets in securities, the average having been raised mainly by the large security holdings—over 30 percent of assets—of the 3 companies in the largest size class. In 1935, however, the proportion of assets held in securities dropped precipitately for these largest companies, possibly because a fourth company was added to the group, possibly because of the rapid increase in consumer lending in 1935, ending the decline that had begun in 1930.[7] The latter possibility is given weight by the fact that the smaller companies too, though less notably, held lower proportions of their as-

[6] Both sets of data exclude Christmas savings and other similar accounts. The number of companies represented in the FDIC data varied from 60 in 1934 to 71 in 1938; for particulars see Table 5, p. 67.

[7] See National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38*, by Duncan McC. Holthausen, in collaboration with Malcolm L. Merriam and Rolf Nugent (1940) pp. 29-32

TABLE 5

Percentage Distribution of Total Assets of Insured Industrial Banking Companies, 1934–38, by Size of Company and Type of Asset[a]

Year	Size of Company[b]	Number of Companies	Type of Asset: Loans and Discounts	Securities	Cash	Miscellaneous	Total[c]	
1934	Under $100	18	70.4	13.9	11.3	4 4	100.0%	$ 5,490
	100– 200	22	69.1	17.9	9.5	3 5,	100.0	14,304
	200– 300	8	75.7	7.8	6.0	10.5	100.0	6,121
	300– 500	5	81.9	4 9	8.8	4.4	100 0	7,497
	500– 1000	4	78.7	8.1	9.8	3.4	100.0	16,245
	1000 & over	3	58.1	30.4	8 0	3.5	100.0	53,098
1935	Under $100	18	68 8	11.6	16 3	3.3	100.0	6,227
	100– 200	22	71.0	16 4	9.4	3.2	100.0	19,265
	200– 300	10	77.3	8.4	7 9	6.4	100.0	8,200
	300– 500	5	83 8	3.7	8.4	4 1	100 0	8,667
	500– 1000	3	85.8	7.2	5.1	1.9	100 0	16,473
	1000 & over	4	75 7	14.2	7.1	3.0	100 0	64,510
1936	Under $100	17	72.8	8 3	12 7	6.2	100 0	5,741
	100– 200	20	73 5	15 0	8 6	2.9	100.0	17,783
	200– 300	13	73.6	11.9	10.1	4 4	100.0	15,333
	300– 500	5	84 4	2.9	9.3	3 4	100.0	9,407
	500– 1000	4	82 8	5.8	9 8	1 6	100.0	22,831
	1000 & over	4	75 6	13 9	6.9	3.6	100.0	75,034
1937	Under $100	20	77.4	6 9	11 3	4.4	100.0	6,985
	100– 200	20	73 7	11.9	11.9	2.5	100.0	19,764
	200– 300	16	73 3	12.1	11.2	3.4	100 0	23,383
	300– 500	5	82 3	3 2	11.3	3 2	100 0	10,600
	500– 1000	3	80.7	8 0	8 3	3 0	100 0	14,233
	1000 & over	5	75.1	11 4	11.1	2 4	100.0	100,298
1938	Under $100	21	74.0	7.7	13 9	4.4	100.0	7,685
	100– 200	19	69.4	12.1	16 2	2.3	100.0	19,233
	200– 300	17	73.9	6 3	16 8	3.0	100.0	25,141
	300– 500	7	66.7	16 0	14.4	2.9	100.0	14,197
	500– 1000	2	86 8	2.4	7.0	3 8	100.0	5,174
	1000 & over	5	73.4	11.7	12.7	2.2	100 0	98,062

[a] Based on year-end data supplied by the Federal Deposit Insurance Corporation.
[b] As measured by total equity account (capital, surplus and undivided profits), in thousands of dollars. Each level is inclusive of the lower figure and exclusive of the higher.
[c] Dollar figures in thousands.

sets in securities in 1935. In the subsequent years security holdings, on the whole, continued to decline in relative importance, and cash balances tended to increase. Table 7 shows that the latter represented, for all insured industrial banking companies, a higher proportion than the former in 1938—13.7 as compared with 10.9 percent of total assets.

That this allocation of funds is fairly characteristic of industrial banking companies in general is suggested by fragmentary supplementary data. Thus balance-sheet figures on 1937 or 1938, available from 15 state banking department reports,[8] show no state in which loans and discounts fall below 60 percent of total assets, and one state in which they amount to as much as 94.7 percent; in most of the reporting states they fall between 70 and 80 percent. As for the Morris Plan companies, it may be estimated[9] that at the end of 1938 loans and discounts accounted for 78.2 percent of their total assets, and securities for 8.3 percent. Two years earlier, at the end of 1936, the proportion of total assets outstanding in loans and discounts was somewhat higher—around 90 percent—for companies affiliated with the American Industrial Bankers Association, as is evident from Table 6. It will be noted that non-investment members of the association—those companies that do not obtain funds through deposits or the sale of certificates—allocate their funds to the various indicated uses in almost exactly the same proportion as do firms that conform with the definition of industrial banking company which is used in this study.

In their characteristic distribution of total assets industrial banking companies are notably different from commercial banks. This fact is of primary importance in explaining the divergences in the profitability records of these two types

[8] The states covered are Connecticut, Florida, Indiana, Maine, Maryland, Michigan, Nebraska, New Hampshire, New York, North Carolina, Ohio, Rhode Island, Utah, Virginia and West Virginia.

[9] From data in Polk's *Bankers' Encyclopedia.*

TABLE 6

PERCENTAGE DISTRIBUTION OF TOTAL ASSETS OF REPORTING MEMBERS OF AMERICAN INDUSTRIAL BANKERS ASSOCIATION, 1936, BY TYPE OF COMPANY[a]

Type of Company[b]	*Number of Companies*	Type of Asset: Loans and Discounts	Cash	Bonds and Securities[c]	Real Estate[d]	Other Assets	Total[e]	
Investment	25	90 2	5.5	1.6	.4	2 3	100 0%	\$10,456
Non-investment	21	88 0	3.4	3 6	1.1	3.9	100 0	3,708

[a] Based on year-end data supplied by the American Industrial Bankers Association.
[b] Investment companies are those companies that accept deposits or sell certificates.
[c] Including bonds of the federal government.
[d] Other than bank building and furniture.
[e] Dollar figures in thousands.

of financial institutions. Data are presented in Table 7 on the asset structure of all industrial banking companies and commercial banks whose deposits are insured by the FDIC, the industrial banking companies that are represented being the same as those that were classified according to size in Table 5. The data cover about one-half the estimated total assets of all industrial banking companies, and nearly all of the assets of commercial banks.

It is clear that the outstanding asset difference between the two types of institutions lies in the relative importance of loans and discounts. While for insured industrial banking companies this item fluctuated, in the period 1934-38, between two-thirds and three-fourths of total assets, for commercial banks it varied narrowly from more than one-quarter to less than one-third. The relative importance of securities

TABLE 7

PERCENTAGE DISTRIBUTION OF TOTAL ASSETS OF INSURED INDUSTRIAL BANKING COMPANIES AND COMMERCIAL BANKS, 1934–38, BY TYPE OF ASSET[a]

Type of Asset	1934 Industrial Bank. Cos.	1934 Commercial Banks[b]	1935 Industrial Bank. Cos.	1935 Commercial Banks[c]	1936 Industrial Bank. Cos.	1936 Commercial Banks[d]	1937 Industrial Bank. Cos	1937 Commercial Banks[e]	1938 Industrial Bank. Cos	1938 Commercial Banks[e]
Loans and discounts	66 6	31 5	76.9	28 9	76.9	28 4	75 7	30 9	72 9	28 2
Securities	20 8	39.1	12 2	39 5	11.5	39 7	10.6	37 8	10 9	37.8
Cash	8.6	24.1	7.7	27.2	8.3	28 0	11 0	27.5	13.7	30 2
Miscellaneous assets	4 0	5.3	3 2	4 4	3.3	3.9	2.7	3 8	2 5	3 8
TOTAL[f]	100 0% $102,755	100.0% $46,439,270	100 0% $123,342	100 0% $50,917,563	100 0% $146,129	100 0% $54,221,369	100 0% $175,263	100.0% $54,212,416	100.0% $169,492	100 0% $56,800,254
Number of institutions	60	14,137	62	14,123	63	13,975	69	13,795	71	13,659

[a] For industrial banking companies based on year-end data supplied by the Federal Deposit Insurance Corporation. For commercial banks based on sources as indicated.
[b] Federal Deposit Insurance Corporation, *Annual Report*, for the year ended December 31, 1935, p. 37.
[c] *Ibid.*, for the year ended December 31, 1936, p. 48.
[d] *Ibid.*, for the year ended December 31, 1937, p. 35.
[e] *Ibid.*, for the year ended December 31, 1938, p. 44
[f] Dollar figures in thousands.

also differs considerably as between the two types of agencies. For industrial banking companies this item amounted to slightly more than one-tenth of total assets for all years except 1934, when it was over two-tenths, but for commercial banks it was practically four-tenths, throughout the period.

While both types of institutions evinced a tendency to maintain an increasing part of their assets in cash over this period, the proportion of industrial banking company assets held in idle cash balances was, in 1937 and 1938, less than one-half the proportion of commercial bank assets kept in this form, and in the earlier years it was one-third or less.

4

Services and Charges

As INDUSTRIAL banking companies have grown in number, size and resources, they have steadily diversified their activities. They now offer a variety of services which they seek to make as flexible as possible, for it is their stated aim to adapt themselves to the "needs of the individual." Since one of their basic functions is to lend money to consumers, they have sought to adjust their lending terms—especially those relating to payments, security and maturity—to the capacity and inclination of the borrower, and to avoid stereotyped forms and procedures.

LENDING SERVICES

It is principally by offering to the public a wider assortment of loans that industrial banking companies have accomplished their purpose of meeting the needs of a great variety of borrowers. It may be observed, however, that in increasing the types of their lending services they have been motivated as much by the twin necessities of meeting competition from other consumer lending agencies and of augmenting their volume of business as they have by a desire to simplify the problem of the man or woman who needs to borrow money.

Types of Loans

It was through its comaker loan that the industrial banking company first established itself as a consumer credit agency, and though in recent years many firms have emphasized

other types of lending services, the comaker loan is still widely regarded as the mainstay of the business. The risk involved in the extension of a loan of this type is dependent on the character and earning power not only of the maker but also of the one or more others—usually friends or relatives—who sign the note. Originally industrial banking firms intended to diversify the risk by stipulating that a comaker be employed in a different industry from that in which the maker was engaged, but there has never been any rigid requirement to this effect. Invariably, however, the credit status of the comakers as well as of the maker is investigated thoroughly; and the standing of the former is studied with particular care when the maker's credit is not altogether satisfactory. These loans are commonly signed by two comakers, and generally run for 12 months. They are paid off, for the most part, in monthly instalments, but for loans of relatively small size and short maturity semi-monthly or weekly payments are sometimes arranged.

Although comaker loans still account for an important part of the volume of industrial banking business, they have tended to decline in relative importance in recent years. Many reasons have been advanced for this change in lending practice. One important cause is the fact that many would-be borrowers find it difficult to find qualified and willing comakers, or are reluctant to seek signers because they prefer not to disclose their need of a loan to friends or relatives. Persons who have previously resorted to comaker loans will often hesitate to call upon the same individuals for additional favors, or fear that by requesting such signatures they have incurred an obligation to sign notes in return. More general reasons are to be found in the force of competitive conditions affecting the companies themselves, and in the constant quest for additional volume which has impelled them to expand into new fields.

Of comparatively recent origin is the single-name loan.

Granted solely on the basis of the maker's income and ability to pay, it requires no other signature than that of the borrower, though it is sometimes signed also by the borrower's wife. Single-name loans are extended to such relatively superior risks as well-known customers of the lending institution, executives with an established and assured income, schoolteachers and other professional persons, and individuals in equally responsible positions. In the granting of such loans group life insurance protection, for the amount of the unpaid balance, is always required.

The requirement of collateral security for the maker's note is another procedure employed by industrial banking companies to minimize risk and at the same time obviate the need for comakers. Such collateral may consist of stocks, bonds, insurance policies, fully paid investment certificates, savings passbooks or household furniture. The desirability of making furniture loans is still the subject of vigorous debate among industrial bankers.[1] Some contend that the collateral does not afford as sound security as does a comaker's signature; others, however, point to the obvious advantage of this type of loan—that it relieves the customer of the embarrassment involved in acquiring a comaker.

Aside from introducing these new types of loans, industrial banking companies have branched out in other directions in order to increase their volume of business. For example, they have entered into agreements with retail establishments, usually department stores, for the financing of time sales. Under an arrangement of this sort the company passes the credits and advances the cash directly to the store; thereafter it makes all collections on the contract. One large Morris Plan company has made such arrangements with a number of stores. On a similar basis some companies advance funds

[1] See Clifton Bourdelais, "Co-maker Loans vs Furniture Loans" in *American Industrial Banker*, vol. 3, no. 4 (October 1937) p. 9.

to persons desiring to pay over a period of time for travel expenditures.

Another scheme which has gained considerable favor is the "creditor plan," whereby an industrial banking company extends a loan to consolidate all the obligations of the maker. Each of the borrower's creditors signs the note and is liable as comaker for an amount or proportion of the unpaid balance equal to the borrower's debt to him. Then, too, there are special terms for certain classes of customers. Thus industrial banking companies, like some personal finance companies, may offer to schoolteachers loans which do not require payments during summer months. One large institution has featured loans that call for much smaller payments during the first six months than during the last six months. Industrial banking companies, especially the larger ones, sometimes make loans on real estate, and also some commercial loans.

In recent years industrial banking companies have tended to do an increasing amount of business in the financing of instalment purchases, particularly of automobiles. There are several ways in which this financing may be arranged. An individual may apply to a lending company for a cash loan and use the proceeds for the purchase of the car, in which case the loan is the same as an ordinary comaker or single-name transaction. Or he may take advantage of the special automobile loan, which requires no signers or guarantors, since the car itself serves as security. The borrower simply makes a down payment and repays the loan within 12 to 24 months. The proportion of the purchase price financed in this way varies among firms and differs also for new and used cars, although in general it represents a conservative portion of the value of the automobile. This type of financing also requires that insurance be purchased on the car, at least against fire and theft. A third method of financing automobile purchases closely resembles the procedure followed

by sales finance companies: a company advances funds to the dealer to enable him to carry wholesale stocks of cars, and the dealer's retail instalment paper is then discounted on some sort of recourse or repurchase basis.

Sales financing by industrial banking companies extends into a very broad range of commodities, including electric equipment for home and farm, agricultural machinery, trailers, heating units and equipment for restaurants, beauty parlors and barber shops. It has been stimulated to a considerable extent by the insurance on real estate modernization loans granted to approved lending institutions under Title I of the National Housing Act. In the years 1934-37 industrial banking companies were responsible for 5.7 percent of the approximately $560,000,000 total of insured loans extended to homeowners for alterations, improvements and repairs. Each of 77 industrial banking companies, representing 1.2 percent of the total number of participating institutions, had an average volume of about $422,000 in insured loans during the four-year period.[2]

Table 8 indicates the comparative importance, as a source of business for insured industrial banking companies and for insured commercial banks, of paper arising out of retail instalment sales. At the end of 1939 only about $29,000,000 of the $541,000,000 of retail instalment paper held by these two types of institutions was held by the insured industrial banking companies. In relation to total customer loans, however, the paper held by the industrial banking companies represented a much greater proportion than did the larger volume held by commercial banks—nearly 23 as compared with only 7 percent for non-member commercial banks and 4 percent for member banks. It is significant to note, too, that for each of these types of institutions by far the greatest

[2] See National Bureau of Economic Research (Financial Research Program), *Government Agencies of Consumer Instalment Credit*, by Joseph D. Coppock (1940) Chapter 2, Table 3.

TABLE 8

RETAIL INSTALMENT PAPER HELD BY INSURED COMMERCIAL BANKS AND INSURED INDUSTRIAL BANKING COMPANIES, DECEMBER 31, 1939, BY TYPE OF INSTITUTION[a]

Type of Institution	*Number of Institutions*		*Retail Instalment Paper*[b]			*Total Ret. Inst. Paper in Percent of Customer Loans*[c]	*Automobile Paper in Percent of Total Ret. Inst. Paper*
	Reporting Some Ret. Inst. Paper	Reporting No Ret Inst. Paper	Automobile	Non-Automobile	Total		
All insured commercial banks and industrial banking companies	*10,382*	*3,116*	*$387,647*	*$153,720*	*$541,367*	*5 1*	*71.6*
Member banks	5,021	1,330	274,758	125,937	400,695	4.4	68 6
Non-member banks and companies							
Commercial banks[d]	5,298	1,779	92,075	20,078	112,153	7 2	82 1
Industrial banking companies[e]	63	7	20,814	7,705	28,519	22 7	73 0

[a] For commercial banks based on data contained in *Federal Reserve Bulletin* (June 1940) p. 526; for industrial banking companies based on data supplied by the Federal Deposit Insurance Corporation.
[b] In thousands of dollars.
[c] Customer loans as used here consist of total loans minus open-market paper, real estate loans and loans for purchasing or carrying securities.
[d] Data obtained by subtracting figures for insured industrial banking companies from figures for all insured non-member banks and companies.
[e] Excluding 4 insured industrial banking companies which are members of the Federal Reserve System, a Morris Plan institution which reports directly to the Comptroller of the Currency, and a Morris Plan institution which recently changed its type of business.

part of the retail instalment paper arose from the sale of automobiles.

Some indication of the diversity of industrial banking companies' lending activities is to be found in Table 9, which

TABLE 9

PERCENTAGE DISTRIBUTION OF OUTSTANDING LOANS AND DISCOUNTS OF INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY TYPE OF LOAN[a]

Type of Loan[b]	*1934*	*1935*	*1936*	*1937*	*1938*
Commercial and industrial loans	[c]	[c]	7 0	6.7	11 7
Real estate loans	6.5	4 7	4.2	4 7	5 6
Commercial paper bought in open market	2	.2	2	.4	6
Loans to banks	4	.1	[d]	[d]	1
All other loans	92 9	95.0	88.6	88 2	82 1
TOTAL[e]	100 0	100 0	100 0	100 0	100 0
	$55,898	$78,122	$92,989	$108,247	$101,015
Number of companies	60	62	63	69	71

[a] Based on year-end data supplied by the Federal Deposit Insurance Corporation Figures are net of repayments on instalment loans

[b] The loan classification is that used in Schedule A, Form 64, of the Federal Deposit Insurance Corporation call report, commercial and industrial loans include "all business loans to individuals, partnerships, and corporations . " and specifically exclude "personal or instalment loans to individuals other than for business purposes . ." (*Instructions for the Preparation of Reports of Condition on Form 64 By Insured State Banks Not Members of The Federal Reserve System*, FDIC, Washington, December 1939, p. 10).

[c] Not reported separately.

[d] Less than 0 1 percent

[e] Dollar figures in thousands.

is based on call reports made to the Federal Deposit Insurance Corporation by the insured companies, these firms accounting for about half the total assets of all industrial banking companies. In spite of the fact that a large proportion of the paper has to be aggregated under the heading "all other loans"—a classification necessitated by the form of the

call report—the table shows interesting relationships between broad types of loans. The lack of data on commercial and industrial loans in the years 1934 and 1935 is undoubtedly due to the practice of the reporting companies in classifying loans, rather than to an absence of loans of this type in their portfolios.

Several other sets of data provide a more adequate statistical description of the directions in which industrial lending has branched out. Table 10, based on information supplied by the Morris Plan Bankers Association, shows that

TABLE 10

PERCENTAGE DISTRIBUTION OF OUTSTANDING LOAN BALANCES OF REPORTING MEMBERS OF THE MORRIS PLAN BANKERS ASSOCIATION, 1936 AND 1938, BY TYPE OF LOAN[a]

Type of Loan	*1936*	*1938*
Comaker and single-name	49.60	50.27
Collateral	8.45	7.46
Sales finance	21.49	22.52
Automobile	*15.39*	*15.92*
Non-automobile	*6.10*	*6.60*
Real estate	1.75	1.50
FHA Title I	12.74	9.06
Other	5.97	9.19
TOTAL	100.00	100.00

[a] Based on data supplied by the Morris Plan Bankers Association. Data for 1936 are as of June 30, number of companies represented is not reported Data for 1938 are as of December 31, covering 80 companies. Total dollar volume not reported for either year

in both 1936 and 1938 the total of comaker and single-name loans advanced by member companies accounted for only half of outstanding loan balances, and that sales financing accounted for more than a fifth. A distribution of loans substantially similar to that shown in Table 10 is to be noted in Table 11, which has been prepared from data for the year

TABLE 11

PERCENTAGE DISTRIBUTION OF VOLUME OF LOANS MADE BY 3 LARGE INDUSTRIAL BANKING COMPANIES, 1937, BY TYPE OF LOAN[a]

Type of Loan	*Company A*	*Company B*	*Company C*
Comaker	23.3	64.2	53.2
Single-name	17.7	0	
Collateral	17.1[b]	9.4	7.3
Sales finance	29.7[c]	19.7	18.5
Real estate	0	0	2.0
FHA Title I	.9	2.2	11.5
FHA Title II	9.9	2.0	7.5
Automobile wholesale	0	2.5	.0
Other	1.4	.0	.0
TOTAL	100.0	100.0	100.0

[a] Based on data supplied by the companies. Data on Company B cover a volume of $12,282,000; for other companies volume figures are not reported Data on Company A cover a sample of 2,352 loans, in amounts up to $1000, made during 1937 and 1938; for other companies figures on number of loans are not reported.

[b] Including 14.2 percent of automobile collateral loans.

[c] *Including 25.3 percent of automobile finance paper.*

1937, supplied by three large industrial banking companies, one in the Middle West and two in eastern states. For Company A additional data not included in this table, covering the years 1936 and 1938, show that over the three-year period 1936-38 there was an increase in both the number and the volume of comaker and single-name loans. The same company reports a rise in automobile and other sales financing from 14.6 percent in 1936 to 18.0 percent in 1938.

Slightly more detailed information is provided by Table 12, which is based on reports for 1936, 1937 and 1938 made by 8 Indiana companies permitted to sell investment certificates. Of especial interest are the data on loans secured by household goods, a classification which comprised 11 percent of all loans made by these companies in 1938.

TABLE 12

PERCENTAGE DISTRIBUTION OF NUMBER AND VOLUME OF LOANS MADE BY 8 INDIANA INDUSTRIAL BANKING COMPANIES, 1936–38, BY TYPE OF LOAN[a]

Type of Loan	*1936*		*1937*		*1938*	
	Number	Volume	Number	Volume	Number	Volume
Comaker and endorser[b]	49 5	40.5	40.6	32 0	40 8	34 6
Unsecured (single-name)			3 3	3 8	8.3	9 4
Collateral[c]	6 3	11.2	.	..		..
Chattel mortgage						
Household goods	8 6	7 6	10.2	8 2	11 2	9 5
Automobiles	15.0	20 5	17.4	23 2	18.7	23.0
Other	.4	9	2 3	4 8	2 8	3.9
Retail instalment sales contract	16 0	10.6	19 2	11.9	13 1	7 6
Real estate mortgage[d]	1.5	4 1	.8	5 8	.6	4.1
Other	2 7	4 6	6 2	10 3	4.5	7.9
TOTAL[e]	100.0%	100 0%	100 0%	100 0%	100.0%	100 0%
	28,891	$5,995	34,248	$7,488	34,977	$6,964

[a] Based on *Annual Report* of the Department of Financial Institutions of the State of Indiana, for the years ended June 30, 1937 (p. 9), June 30, 1938 (p. 91) and June 30, 1939 (p 69); data are for the calendar years indicated.
[b] Excluding "husband and wife" loans.
[c] Marketable securities, etc. This classification was not used in the reports for 1937 and 1938.
[d] Excluding mortgages taken as additional security.
[e] Dollar figures in thousands.

Data supplied by a large Morris Plan company, presented in Table 13, indicate the comparative importance of the various types of loans extended by this company during the fifteen-year period 1925-39. Comparable data are not available for other companies, but the figures on this one institution, while they are not to be taken as entirely representative, do illustrate a trend in lending activities which is probably

TABLE 13

PERCENTAGE DISTRIBUTION OF VOLUME OF LOANS MADE BY A LARGE MORRIS PLAN BANKING COMPANY, 1925–39, BY TYPE OF LOAN[a]

Year	*Co-maker*	*Single-Name*[b]	*Col-lateral*	*Auto-mobile*[c]	*Other*[d]	*Total*[e]	
1925[f]	89 0	0	8 0	.2	2 8	100.0%	$ 815
1926	85 8	.0	10.4	4	3.4	100.0	1,673
1927	82 5	0	13.1	1 8	2 6	100 0	2,120
1928	77.9	.0	11 9	7 1	3 1	100 0	2,437
1929	89 2	.0	8 5	2 3	0	100 0	2,355
1930	94 9	0	5.1	0	0	100 0	2,394
1931	96 6	0	3 4	.0	0	100.0	2,362
1932	97 2	.0	2.6	0	.2	100 0	2,419
1933	96 8	0	3 2	0	0	100.0	2,030
1934	96 8	.0	3 2	0	0	100 0	1,841
1935	94.5	.0	2 8	0	2 7	100 0	2,042
1936	76 0	9 1	2 6	9 3	3 0	100 0	2,861
1937	60.3	29.1	2 3	7 5	.8	100 0	3,279
1938	58.6	30 3	2 4	7.5	1 2	100.0	3,769
1939[g]	56 7	30.6	2 3	9 3	1 1	100 0	2,899

[a] Based on data supplied by the company.
[b] Including "husband and wife" loans.
[c] Including cash loans made on automobile collateral as well as loans made to finance automobile purchases
[d] Including equipment, FHA Title I and Title II loans, and trade acceptances other than automobile
[e] Dollar figures in thousands.
[f] April 1 to December 31
[g] January 1 to August 31

characteristic of many of the larger firms. Of particular interest is the indication that this company did not markedly diversify its services until 1936. Up to that year (except for 1927 and 1928) more than 85 percent of its loans, as measured by volume, were of the comaker type, and except in the first five years of the period the percentage of such loans was 95 or higher. In most of the years before 1936 the only other significant type of lending carried on by this company

was the extension of collateral loans, though after 1927 these showed an almost uninterrupted decline in relative importance. In 1936 a change in management occurred and there began a rapid expansion of new types of lending. Comaker loans declined conspicuously in relative importance, accounting for less than 57 percent of the company's total loan volume during the first eight months of 1939. Single-name loans, which were not granted at all before 1936, represented nearly 31 percent of the total loan volume at the end of this period, and loans made on automobile collateral, or for the financing of automobile purchases, amounted to nearly 10 percent.

The data that have been presented indicate a general decline in the relative importance of comaker loans extended by industrial banking companies. They also give evidence of a relative increase in the volume of single-name loans, and of automobile and other sales financing transactions.

Duration and Size of Loans

No detailed data are available on the maturity of loans made by industrial banking companies. It is known, however, that cash loans extended by these firms generally have a 12-month duration unless they are granted for very small amounts, in which case the note may be for only 3 to 6 months. Industrial banking companies which finance automobile and other purchases usually prescribe contract lengths similar to those favored by other consumer financing institutions. Thus automobile loans generally run from 18 to 24 months,[3] but a shorter or a longer contract may be offered if the type of car being financed and the practice of competing agencies make a modification in terms desirable. The financing of purchases of less expensive items generally involves shorter

[3] Myron R. Bone, "Current Trends Are Revealed by Survey" in *American Industrial Banker*, vol 4, no. 5 (October 1938) p. 5.

contracts. Real estate and modernization loans, on the other hand, may run for two years or more.

On the size of loans somewhat more detailed information is available, though it is not altogether satisfactory either in form or in coverage. A recent survey of the lending practices of members of the American Industrial Bankers Association indicates that these companies make loans ranging in size from $10 to $10,000, and that on rare occasions they extend even larger sums. It is not likely that loans made in sizes near the upper limit of this range are strictly consumer loans. They may be made to merchants on the security of a group of accounts receivable, to be collected by the lender, or they may be straight commercial loans repayable in regular instalments. It appears also that it is the practice among some companies not to advance a loan of less than $50 or $75.[4] As was pointed out in Chapter 2, the maximum limit of loans is set in some instances by the law under which the companies operate. Where the governing legislation is a small loan law, as in Maryland, cash loans are limited to $300. In the District of Columbia companies are not allowed to lend more than $200 to a single borrower. Neither in Maryland nor in the District of Columbia, however, do these limitations affect companies that operate under the general banking code. Nor do legal provisions of this sort affect transactions which do not involve an advance of cash; thus the amount of sales finance credit extended by industrial banking companies is determined by their own judgment.

The survey just mentioned includes not only industrial banking companies as defined in this study, but also institutions which neither take deposits nor sell investment certificates. The average size of loans extended by companies in this mixed group ranges from $90 to $260, with the ma-

[4] *Ibid.*, p. 5.

jority reporting an average of $175 to $210.[5] Other data supplied by the American Industrial Bankers Association, based on reports by its members, show that the average size of loan accounts opened was $159 in 1936, $167 in 1937 and $187 in 1939. These averages, too, are for a mixed group, comprising a limited number of relatively small firms—38 companies in 1936, 26 in 1937 and 44 in 1939. Data on the average size of loans made by 10 comparatively large Morris Plan industrial banking companies during the period 1929-38 are given in Table 14, which shows that the average loan

TABLE 14

NUMBER, VOLUME AND AVERAGE SIZE OF LOANS MADE BY 10 MORRIS PLAN BANKING COMPANIES, 1929–38[a]

Year	*Number of Loans*	*Volume of Loans*	*Average Size of Loans*
1929	351,941	$ 95,396,846	$271
1930	351,080	90,444,349	258
1931	332,578	85,866,829	258
1932	277,472	66,696,643	240
1933	256,730	58,496,361	228
1934	290,049	70,835,507	244
1935	354,379	93,154,454	263
1936	388,955	106,049,074	273
1937	370,027	117,345,757	317
1938	404,226	116,289,561	288

[a] Based on data supplied by The Morris Plan Corporation of America.

made by these companies fell from $271 in 1929 to a low of $228 in 1933, rose to $317 in 1937, and declined to $288 in 1938.

Differences from one company to another in the average size of loans doubtless reflect in large degree variations in the types of loans extended. Again, however, only limited data are available. As can be seen from Table 15, loans

[5] *Ibid*, p. 5.

TABLE 15

AVERAGE SIZE OF LOANS MADE BY 8 INDIANA INDUSTRIAL BANKING COMPANIES, 1936–38, BY TYPE OF LOAN[a]

Type of Loan	*1936*	*1937*	*1938*
Comaker and endorser[b]		$ 172	$ 169
	$170		
Unsecured (single-name)		249	227
Collateral[c]	370	.	
Chattel mortgage			
Household goods	183	175	169
Automobiles	285	292	245
Other	419	464	277
Retail instalment sales contract	137	135	116
Real estate mortgage[d]	560	1,670	1,478
Other	350	366	345
TOTAL	208	219	199

[a] Based on *Annual Report* of the Department of Financial Institutions of the State of Indiana, for the years ended June 30, 1937 (p. 9), June 30, 1938 (p. 91) and June 30, 1939 (p. 69); data are for the calendar years indicated.
[b] Excluding "husband and wife" loans.
[c] Marketable securities, etc This classification was not used in the reports for 1937 and 1938.
[d] Excluding mortgages taken as additional security

made by 8 Indiana companies authorized to issue investment certificates averaged $208, $219 and $199 in 1936, 1937 and 1938 respectively (the average was $195 in 1935). In the different types of loans, however, there was considerable deviation from these averages. Comaker loans, and those secured by household chattels, were well under average, as was also the typical amount of credit extended on retail instalment sales contracts. Unsecured single-name loans were somewhat larger than average, and loans secured by automobiles, or by marketable securities, were still larger. The handful of loans secured by real estate mortgages was, of course, far larger than the other types.

A fifteen-year record covering the average size of loans

made on different types of security by a large Morris Plan industrial banking company is presented in Table 16. The relatively large size of loans extended on automobile collateral during the years 1925-29 doubtless reflects the inclusion in the data of some wholesale loans; such loans are not represented in the figures for 1936-39. In 1937-39 loans secured by automobiles were roughly the size of comaker loans, and were considerably smaller than single-name loans, probably because this particular bank does no automobile

TABLE 16

AVERAGE SIZE OF LOANS MADE BY A LARGE MORRIS PLAN BANKING COMPANY, 1925–39, BY TYPE OF LOAN[a]

Year	*Co-maker*	*Single-Name*[b]	*Col-lateral*	*Auto-mobile*[c]	*Other*[d]	*All Loans*
1925[e]	$183	$ 0	$212	$ 622	$226	$186
1926	193	0	248	310	192	198
1927	217	0	374	610	233	233
1928	234	0	556	1,706	222	268
1929	248	0	389	5,012	163	262
1930	260	0	284	0	0	261
1931	266	0	201	0	0	263
1932	251	0	179	0	639	249
1933	232	0	170	0	0	230
1934	228	0	173	0	0	225
1935	246	0	175	0	260	243
1936	270	290	222	349	440	279
1937	262	306	212	253	386	272
1938	259	320	194	253	429	274
1939[f]	271	301	192	275	425	278

[a] Based on data supplied by the company.
[b] Including "husband and wife" loans.
[c] Including cash loans made on automobile collateral as well as loans made to finance automobile purchases.
[d] Including equipment, FHA Title I and Title II loans, and trade acceptances other than automobile.
[e] April 1 to December 31.
[f] January 1 to August 31.

sales financing through dealers. Single-name loans, which were not extended before 1936, averaged considerably larger than collateral loans, and somewhat larger than comaker notes. It was only after 1930, however, that comaker loans were larger than those secured by collateral.

The relative importance of loans of different sizes is indicated in Table 17, which is based on data for the same 8 Indiana companies represented in Tables 12 and 15. In 1937 over 80 percent of the loans, and in 1938 nearly 85 percent, were for amounts of $300 or less. For each of the two years, roughly a third of the total number of loans were for $25 to $100, though in volume loans of this size accounted for only about one-eighth. These data, however, are for fairly

TABLE 17

PERCENTAGE DISTRIBUTION OF NUMBER AND VOLUME OF LOANS MADE BY 8 INDIANA INDUSTRIAL BANKING COMPANIES, 1937–38, BY SIZE OF LOAN[a]

Size of Loan[b]	*1937*		*1938*	
	Number	Volume	Number	Volume
$ 25–100	32.5	11.0	33.9	12.4
100–150	18.7	10.6	20.3	12.8
150–200	13.2	10.8	14.0	12.2
200–300	16.5	19.1	16.5	19.1
300–500	12.4	21.9	10.7	24.6
500–1000	5.6	17.9	3.8	12.1
Over 1000	1.1	8.7	8	6.8
TOTAL[c]	100.0%	100.0%	100.0%	100.0%
	27,424	$6,168	30,207	$6,147

[a] Based on *Annual Report* of the Department of Financial Institutions of the State of Indiana, for the years ended June 30, 1938 (p. 91) and June 30, 1939 (p. 69); data are for the calendar years indicated.

[b] Each level (except the first, which includes $25 loans) is exclusive of the lower figure and inclusive of the higher.

[c] Excluding real estate loans and purchases of retail instalment sales contracts. Dollar figures in thousands.

average-size companies. That they are not necessarily representative for very large industrial banking companies is indicated by a study of 2,948 loans made by such a company in 1937. In this sample only 32 percent of the total number of loans were for amounts under $300, while 20 percent of all the loans were for $1000 or more.

The lending policies of the 8 Indiana industrial banking companies already referred to are compared in Table 18 with those of small loan companies operating in the same state. The distributions include all loans made by the small loan companies but for industrial banking companies they include only those loans which are for $300 or less, $300 being

TABLE 18

PERCENTAGE DISTRIBUTION OF VOLUME OF LOANS OF $300 OR LESS MADE BY INDIANA INDUSTRIAL BANKING COMPANIES AND SMALL LOAN COMPANIES, 1937–38, BY SIZE OF LOAN[a]

Size of Loan[b]	*1937* Ind. Bkg. Cos[c]	*1937* Small Loan Cos.	*1938* Ind. Bkg. Cos.[c]	*1938* Small Loan Cos.
$ 25 or less	.0	1.5	0	1 6
25– 50	21.4 (25–100)	7.0	21.9 (25–100)	7 1
50–100		18 0		18 2
100–150	20 6	15.4	22.6	16 1
150–200	21 0	18.5	21.6	17.9
200–300	37.0	39.6	33 9	39.1
TOTAL[d]	100.0%	100 0%	100 0%	100.0%
	$3,177	$32,842	$ 3,467	$30,939
Number of companies	8	274	8	279

[a] Based on *Annual Report* of the Department of Financial Institutions of the State of Indiana, for the years ended June 30, 1938 (pp. 91 and 144) and June 30, 1939 (pp. 69 and 112); data are for the calendar years indicated.
[b] Each level is exclusive of the lower figure and inclusive of the higher.
[c] Authorized to sell investment certificates.
[d] Dollar figures in thousands.

the maximum loan permitted by law for small loan companies in Indiana. These figures reveal a notable similarity in the practices of the two types of companies. Both in 1937 and in 1938, however, the industrial banking companies granted a somewhat smaller proportion of their loan volume in loans of $100 or less, and a somewhat larger proportion in $100-200 loans. The $200-300 loans accounted for slightly higher percentages in the small loan companies' distribution than in that of industrial banking companies.

Methods of Loan Repayment

Payments on loans made by industrial banking companies may be applied directly to the face amount of the loan, or set up in an hypothecated deposit account, or applied to the instalment purchase of a pledged investment certificate. The first of these methods is commonly used for repayments on trade acceptance loans, FHA loans and other transactions which do not involve an extension of cash to the borrower. Cash loans, on the other hand, are usually repaid either by the accumulation of an hypothecated deposit account or by the purchase of a pledged certificate. The practice a given company will follow depends upon the legal conditions under which it operates.

Where a cash loan is involved, the accumulated instalment payments made by the borrower are not applied to the loan until its maturity. Although there is no requirement that the hypothecated deposit or the sum accumulated by the instalment purchase of the certificate be used to pay off the loan, this procedure is followed almost without exception. Where industrial banking companies have a deposit-taking privilege these accumulated payments may be reported as "repayments on loans not directly applied to loans." Most companies report separately gross loans outstanding and hypothecated certificates, but a few exclude the latter from

their reported liabilities and report a single figure for net outstandings.

The significance of the procedure followed in accepting loan repayments lies in the way in which it affects the computation of the effective interest rate paid by the borrower. In Chapter 2 it was pointed out that the sale of a certificate of indebtedness or investment at the time a loan is granted is held in some states to be a separate and distinct transaction, thus creating a legal fiction to the effect that the loan is not paid off in instalments. It is possible to argue, on the basis of this legal distinction, that the effective rate of interest is the rate at which the loan is discounted, whereas it is approximately double that rate if the loan is regarded as an instalment transaction, with a regularly declining principal balance.

CUSTOMER CHARGES

Many of the state laws regulating industrial banking companies not only set maximum rates of interest or discount but also indicate what additional charges may be levied. Often, however, companies lower their rates and charges below the legal maximum in order to meet competition. It should be noted that in almost all industrial loan laws the rate provisions apply only to cash loans; credit extended to finance the time sale of merchandise is not affected by such provisions, except in Indiana and Wisconsin.

The industrial banking company characteristically quotes loan costs as a certain rate of discount plus a charge for credit investigation. In this respect it differs from the personal finance company, which usually levies its charge as a specified rate per month on unpaid principal balance. Sometimes, however, industrial banking company rates are stated in more complicated terms, and in any case a number of considerations must be taken into account in computing

the actual cost to the borrower. This cost may include a fine for delinquent payments and a fee for insurance, as well as the discount charge and credit investigation or service fee. From this sum must be deducted any rebate granted for prepayment of the loan or for prompt payment, and any interest credited to the borrower on the deposit accumulated or the instalment certificate employed as a device for payment of the loan. While few companies actually impose all these charges and grant all these rebates and interest payments, each loan must be examined from every one of these angles before the actual cost to the borrower can be ascertained. His cost varies also, of course, with the size and duration of his loan, and perhaps with the kind of security he provides.

Computation of the effective rate of interest must take into account the fact that industrial loans are paid off in regular instalments. As has already been stressed, the effective rate on such a loan is higher than the stated rate of discount. On a $100 loan, for example, carrying a 6 percent discount deducted from the face amount of the note, and repayable in 12 equal monthly instalments, the effective rate of interest is 11.8 percent.[6]

On rates charged by Morris Plan banking companies no data are available which are sufficiently extensive to be used in any other way than as scattered examples of forms of quotation and general levels of charge. As for rates charged by other industrial banking companies, some facts are brought out in a recent study by the American Industrial Bankers Association. Almost half of the companies which submitted data for this survey employed a base rate of 6 percent discount plus an investigation fee of $1 per $50 on loans up to $250 or $500, and a smaller fee or none at all on

[6] See the discussion in National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit*, by John M. Chapman and Associates (1940) p. 153.

loans above these amounts.[7] Of the reporting companies, 35 percent varied their rates according to the type of security. The lowest rate reported, 5 percent discount, was that charged for FHA Title I insured loans.

There is little uniformity among industrial banking companies as to the scale of rates for different types of loans. Generally, however, where a variation prevails, comaker loans are discounted at a higher rate than loans secured by savings passbooks, stocks or bonds. Frequently single-name loans carry a higher discount rate than comaker loans, or involve a higher investigation charge; on the other hand, they may be made at a lower rate than that charged on comaker loans, especially if they are of relatively large amounts. Loans secured by automobiles and household furniture likewise tend to carry a rate higher than that applied to comaker loans.

The size of a loan is an important criterion in the setting of rates. One company advertises that it makes no service charge and discounts at 8 percent on loans up to $500 in size, at 7 percent on loans from $500 to $1000, and at 6 percent on loans above $1000. Another company, which charges 6 percent on all loans, varies its investigation fees so that the percentage charge on a large loan is less than that on a smaller loan. This company levies a credit investigation fee of $2 on each $100 and sets a maximum fee of $6. No fee is imposed for collateral loans, even those below $300, and for $300-500 loans no fee is set regardless of the type of security. Borrowers of $500 and over are not only charged no credit investigation fee but they receive interest, at the rate of 2½ percent per annum computed on a quarterly basis, on the monthly deposits which they accumulate to liquidate their loans.

The rates recently put into effect by another large industrial banking company provide a further illustration of the adaptation of charges to the size and type of the loan. For

[7] Myron R. Bone, "Industrial Banks Loan Many Millions Yearly" in *American Industrial Banker*, vol. 4, no. 6 (December 1938) pp. 7-8.

comaker loans the rate is 6 percent, plus a service fee ranging as low as 1¼ percent and never in excess of 2 percent, depending on the size of the loan. No service fee is charged on loans of $700 or over. Loans secured by stock exchange collateral carry a rate of 5 percent if the amount is less than $1000, and of 4½ percent if the loan exceeds $1000. Loans secured by the bank's own certificates of deposit or by savings passbook accounts are charged the lowest rates. Those of less than $300 are discounted at 4½ percent, those of $300 to $500 at 4 percent, and those of $500 or more at 3½ percent.

The amount that a loan costs the borrower generally includes an insurance fee. On cash loans this insurance covers the life of the borrower, and provides for payment of the unpaid balance if he should die before the loan is paid off. Insurance is not always required, but when it is the borrower generally pays $1 per $100 for this coverage. For large loans, those of $500 or more, the company may carry the insurance without levying a special charge on the borrower.

The effective rates of interest on different sizes of loans are sometimes influenced considerably by the imposition of minimum charges. A company may impose a minimum charge of $1 on loans of $10 which are payable in 2 months, or it may state its credit investigation fees as a flat dollar charge, regardless of the size of the loan.

The problem of calculating the amount that a loan costs the borrower is further complicated by the practice of levying special delinquency charges. Thus for persons who fail to make payments promptly the cost may be increased substantially by the amount of the delinquency fine. In imposing this penalty not all companies define delinquency in the same way. Some maintain that a loan is delinquent if payment is not made on the due date; others grant a period of grace ranging from 2 to 10 days; still others do not consider a loan delinquent until a payment is 60 days overdue. Some companies, however, are not allowed by the law under which they

operate to charge any delinquency fee at all, and even the companies that are not subject to such a legal prohibition may not find it advantageous to exact a fee of this sort. Many have found that the amount of money thus collected does not compensate them for the ill-will engendered in the customer by the imposition of the fine. Delinquency fees are far from uniform; most companies charge 5 percent of the past-due payment, but some have a fixed minimum charge.

On the other hand, the allowance of rebates for prompt payment or prepayment reduces the cost of the loan to the borrower. In a few states industrial loan laws provide for a standard system of rebates for prepaid loans. In Indiana, for example, the Industrial Loan and Investment Act sets a minimum rebate on Class I loans of 1 percent per month on the amount prepaid, except that no rebate need amount to more than the original discount minus 3 percent of the original sum lent. Where rebates are not governed by law or administrative rulings, companies follow various methods; they may rebate unearned discount minus a minimum charge, or refund the full amount or some fraction of unearned interest.

The borrower's cost may be cut down somewhat if the company pays interest on hypothecated deposits. Few companies, however, follow this practice at the present time, and those which do so may pay interest only on deposits accumulated on loans above a set amount. For example, on deposits accumulated on loans of $500 and over, the Morris Plan Bank of Virginia pays interest at the same rate that it pays on unhypothecated deposits.

NON-LENDING SERVICES

From their inception industrial banking companies have sought to be more than consumer lending agencies. Many firms originally planned to serve also as thrift or savings in-

stitutions, for example, even though the legal arrangements under which they operated did not permit them to present themselves as savings institutions. From the point of view of the small company, thrift services are a desirable practice, for small companies can obtain funds in this way at lower rates of interest than they would have to pay to other potential sources of working funds.

State prohibitions against the acceptance of deposits have made it necessary for industrial banking companies to resort to the sale of various kinds of investment certificates in order to fulfil the savings or thrift function. These unhypothecated certificates vary considerably in form, but they have a strong basic similarity. They run for varying periods of time and carry different rates of interest; usually they are issued in relatively small, fixed denominations, and they may be paid for outright or in instalments. Where companies have been given deposit-taking privileges it is possible for the usual savings passbook to be used, and in such cases the instalment investment certificate may be dispensed with.

The rate paid on unhypothecated investment certificates varies with the size and maturity of the certificate, but funds obtained in this way generally prove more costly to the industrial banking company than do savings deposit funds. A recent survey conducted by the American Industrial Bankers Association shows that interest on certificates ranges from 3½ to 5 percent, and that some companies pay as much as 6 percent. On the other hand, interest on savings accounts varies between 1½ and 4 percent.[8] The latter, for the 4 companies which are now members of the Federal Reserve System and the 75 companies now insured by the Federal Deposit Insurance Corporation, is subject to legal regulation. These two government agencies set the same maximum rates on time deposits: 2½ percent on savings deposits and on time deposits

[8] Myron R. Bone, "Current Trends Are Revealed by Survey" in *American Industrial Banker*, vol. 4, no. 5 (October 1938) p. 5.

payable in 6 months or more; 2 percent on time deposits payable in 90 days to 6 months; and 1 percent on time deposits payable in less than 90 days.[9]

Where the law permits, industrial banking companies also offer their customers checking or demand account facilities. They usually arrange this service by selling the customer a book of 20 checks for $1.50, and require no minimum balance. Other services which are becoming increasingly common are such special plans as those designed to facilitate Christmas and vacation savings; in most instances no interest is paid on deposits of this nature. Finally, a few companies offer safe deposit accommodations to their customers.

Although it is impossible to depict statistically the pattern of lending and non-lending functions of industrial banking companies, all indications support the contention that the prevailing tendency, over the past thirty years, has been toward a diversification of services. At the present time the exigencies of the competitive situation are providing further stimuli in this direction.

[9] Federal Reserve System, *Twenty-fifth Annual Report of the Board of Governors,* covering operations for the year 1938, p. 59, and Federal Deposit Insurance Corporation, *Annual Report,* for the year ended December 31, 1936, p. 91.

5

Operating Methods and Collection Experience

THE ways in which industrial banking companies obtain and handle business are fundamentally similar to those followed by other consumer credit agencies. Since many industrial banking companies are engaged in a more diversified type of lending, and offer in addition certain non-lending services to their customers, their problems differ somewhat from those of other agencies. But like other comparable institutions they are required to conduct an effective promotional campaign to insure maximum employment of their lending capacity; out of the total number of loan applications filled out by prospective borrowers they must select a group to whom loans will be made; because their selection must be speedy as well as careful, they must develop procedures that will facilitate their choice of risks. These various practices will be discussed in this chapter, and in the concluding section their adequacy will be measured by a body of data covering collection experience on accepted loans.

METHODS OF OBTAINING AND HANDLING BUSINESS

Advertising Techniques

In industrial banking, as in other fields of consumer credit, the so-called "repeat" borrower is an important source of loan volume, but what proportion of the industrial lending

business is to be ascribed to loans to old customers cannot be ascertained exactly. The fact that most of the firms circularize those who have proved to be reliable risks is in itself indicative. Replies to a questionnaire distributed by the American Industrial Bankers Association indicate that somewhat more than half of the loan volume of the reporting companies came from former borrowers.[1] These data, however, cover only a small proportion of the total volume of industrial lending, and they make no distinction between investment and non-investment types of agencies.

In their endeavor to attract new borrowers, and to win over the clients of competitors, industrial banking companies must engage in various forms of advertising. It is not possible to say with any definiteness how much is spent for this purpose. One figure frequently mentioned as a standard is ½ to 1 percent of total loan volume, with the qualification that a new company is likely to spend more and an old company less. According to information supplied by the American Industrial Bankers Association, reporting members in 1937 carried an average advertising budget of from ⅓ to 1 percent of the total volume of their loans during that year. In 1936 the members of the association reported that advertising expenses amounted, on the average, to about 2½ percent of gross income. As far back as 1925 the advertising outlays of 25 reporting members of the Morris Plan Bankers Association amounted to 4.8 percent of gross expense and 3.6 percent of gross income.[2] A year later 19 New England Morris Plan companies reported that their outlays for advertising amounted to 5.6 percent of their gross expense and 4.4 percent of their gross income.[3]

[1] Myron R. Bone, "Industrial Banks Loan Many Millions Yearly" in *American Industrial Banker*, vol. 4, no. 6 (December 1938) p. 7.

[2] Walter D. Brown, "Comparative Statistics for the Year 1925" in *Morris Plan Banker* (January 1926) pp. 17-21

[3] Walter D. Brown, "Average Income and Expense Figures, 19 Morris Plan Companies" in *ibid.* (May 1927) p. 113.

These proportions have remained substantially constant, as is indicated by the fact that in 1937 companies reporting to the Morris Plan Bankers Association were allocating 5.9 percent of their total expenses to advertising.[4]

While many types of advertising are used, there seems to be a general tendency for companies to concentrate on newspapers and direct mailing as means of reaching potential borrowers. Other media are billboards, posters, window cards, radio, personal canvass, advertisements in street cars or directories or on moving picture screens, and the multitude of items distributed free of charge.

The advertising problem of industrial banking companies differs somewhat from that of most other businesses in that industrial lenders are concerned with attracting only acceptable applicants, since the cost of making loans is augmented when a company has to examine and reject poor risks. From this point of view direct mail advertising has much to commend it, for it reaches a select group, whereas radio programs, billboard posters or other non-selective forms of advertising may interest large numbers of applicants of whom the majority may have to be rejected.

Except when they are engaged in launching a new service, industrial banking firms tend to emphasize the most profitable types of loans in their advertising. In general, they follow a schedule of advertising copy designed to fit the different periods of the year, sometimes employing the services of outside advertising agencies. Many companies have succeeded to some extent in determining which of their advertising techniques is most productive by asking the new customer the reasons for his choice of company. The replies may be somewhat unreliable, but they usually indicate that references from old customers yield more new business than any of the forms of commercial advertising employed.

[4] Derived from data supplied by the Morris Plan Bankers Association.

Office Organization

Broadly speaking, the office organization of an industrial banking company is set up along the lines of the firm's principal activities—extending credit, receiving payments, keeping records and collecting accounts. It varies, however, with the size of the firm, the amount of business handled and the assortment of services offered. Small companies are similar in office organization to the independent personal finance companies; the staff usually consists of a manager, an assistant and a secretary. At the other extreme are the very large firms that have a much larger and more specialized corps of workers. One large company, for example, has a department for receiving applications, a women's department, a special organization of committees to pass on loan applications, departments for receiving hypothecated and unhypothecated deposits, a checking account division, a sales finance section, and adjustment, legal, auditing and accounting, insurance, purchasing, advertising, personnel and real estate departments.

One way of measuring the efficiency of an office organization is to determine how many loans are made per year per employee. Although such data are fragmentary at best, it seems reasonably safe to say that for industrial banking companies the average number of outstanding loan accounts per employee is in the neighborhood of 300. A study made in 1935, covering 16 Pennsylvania companies with average outstandings of about $120,000, showed that the average number of loans outstanding per full-time employee was 303.[5] Somewhat more than half the member companies reporting to the American Industrial Bankers Association over the period 1935-39 had in those five years an average of 200 to 500 loan accounts outstanding per employee.[6] The figure

[5] Harry R. Hickox, "Volume, Losses and Costs Studied in Pennsylvania" in *American Industrial Banker*, vol. 1, no. 2 (June 1935) p. 6.

[6] Data supplied by the American Industrial Bankers Association.

of 300 loan accounts outstanding per employee is regarded as a rough standard of efficiency.[7]

Credit Procedure

The procedures followed in the granting of loans, the investigation of credit and the collection of payments vary for different types of loans and for companies of different sizes. Large firms tend, on the whole, to adopt a more highly standardized and routinized procedure than do small firms. In a relatively small office the procedure is fairly simple. The applicant is first interviewed by the manager or his assistant. Then he fills out the usual loan application blank and arranges to present collateral security, or to obtain the signature of comakers, or to have his car or household chattels inspected. The applicant's credit record is then checked. If he is a regular customer the checking is quickly accomplished. If he is not, various sources of credit information must be consulted, the type of credit investigation depending in large part on the facilities available.

First, the office may have its own credit file containing published notes on suits, judgments, foreclosures and the like. Second, there is almost always some kind of mercantile credit agency in the community, from which reports on prospective borrowers may be purchased. These reports in some instances relate exclusively to open-book accounts; in

[7] Data on "loan accounts per employee" must be examined with great care Sometimes they refer to average loan accounts outstanding, sometimes to loans made during the year, and in either case there is usually some doubt as to the number of employees to be included in the calculation, the latter difficulty arises particularly from the fact that there are often part-time as well as full-time workers. Furthermore, it is necessary to take account of the fact that an industrial banking company has savings as well as loan accounts, which must be handled by the same working force, and that there may be variation among companies in regard to the frequency of instalment payments made on loans, some companies make loans that are repayable on a weekly basis, thus increasing the number of transactions to be handled by the working force. Considerations such as these doubtless explain the wide variations in reports on "number of loan accounts per employee."

others they cover retail instalment credit as well. For loans of $1000 or more the company may buy a more exhaustive credit report, as well as a legal report on suits and judgments in which the applicant may have been involved. Finally, there may be a central lenders' credit bureau from which information may be obtained as to the applicant's present status and past record with cash lending and sales financing firms. In some instances the credit bureau serves only as a clearing agency, in which case the lender has to make a special inquiry of the firms to which he is referred. The credit bureaus differ in scope and reliability from one locality to another. In some cities all lenders, regardless of type, cooperate in exchanging information; in others intense competition may lead to a complete breakdown of the system.

In addition to seeking information from whatever organized credit bureaus or exchanges are available, the company makes its own check of the applicant's employment, income, residence and family indebtedness. In most cases this amounts only to verification, by telephone, of information given by the applicant. Some lenders in the smaller cities hold regularly scheduled weekly meetings at which the delinquent accounts of all lenders are reviewed and discussed. It is rarely the case that a company will utilize all of these sources of credit information, for some are considered more useful than others and each tends to increase the cost of credit investigation.

If the loan is made on the security of a chattel mortgage on household furniture an appraiser is sent to visit the home and to make a general inspection of the household. Since foreclosures on household chattels are relatively rare,[8] the chief purpose of the home inspection is to impress the bor-

[8] See National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (1940) Table 18, p. 77.

rower with the desirability of prompt payment and to judge from the atmosphere and upkeep of the household whether the risk is likely to be a good one. If the loan is made on automobile collateral, the car is carefully inspected and valued.

When all of the relevant information has been assembled and written on or attached to the loan application, a decision is made on the extension of the credit. In a small office the entire loan procedure may be handled by one person, whereas in the larger firms it involves a highly systematized division of labor, with the loan officers passing only on credits, and the interviews and investigation conducted by others. In some cases there is a hierarchy of loan officers; thus in one large company the less experienced men are permitted to extend loans up to $360, the next group up to $540, the next to $1200, and loans for more than $1200 are usually passed by the principal officer of the firm. Another common practice is the pooling of the responsibilities of two officers, who may together examine an application and grant a loan equal to the sum of their separate credit authorities.

An important element in the credit granting organization is the group referred to as the "discount committee" or the "loan committee." Where there are several loan officers, applications are routed through the desks of all the officers, the committee thus operating continuously. For very large loans the committee may be composed of a selection of loan officers, the president of the company and several directors, the group meeting only at regular intervals.

It is difficult to assemble adequate statistical data on the proportion of credit applications accepted by industrial banking firms. One company operating a series of offices reports that about one-third of the requests for loans are rejected without the applicant's reaching the point of making out a formal blank; of those actually made out, between

one-quarter and one-half are finally accepted. An officer of one of the largest industrial banking companies has stated that during 1938 his firm extended 40,000 loans out of 60,000 or more applications.[9] Another firm states that it rejected 10 percent of the applications received during the year 1939.[10] A survey made in 1938 by the American Industrial Bankers Association, covering the practice of member companies, revealed that approximately 75 percent of all loan applications received by all the reporting firms were finally accepted; but some companies reported acceptances amounting to 80 or 90 percent, others a much smaller proportion, and one firm stated that it granted only 35 percent of the number of loans requested.[11]

The initial steps in the sales financing operations of an industrial banking company differ substantially from those described above.[12] Because the company wishes to avoid repossession problems it will make the same careful credit examination in such cases as it does for cash loan applications, but its relations with the dealer who is the original source of the financing paper introduces new problems, and the documents required to protect the lender's interest in the collateral are quite different. It is essential in this type of business to secure protection against such hazards as duplicate or triplicate financing, excessive dealer payments, illegal sale of merchandise or overvaluation of collateral in transactions involving used commodities. While these hazards are well known to experienced operators, the fact

[9] Stephen B Clark, "People and Profits in Personal Loans" in *American Industrial Banker*, vol. 5, no. 1 (February 1939) p. 14

[10] Morris Plan Bank of Virginia, *Annual Report to the Stockholders*, for the year 1939, p. 3.

[11] Myron R. Bone, "Industrial Banks Loan Many Millions Yearly" in *American Industrial Banker*, vol. 4, no. 6 (December 1938) p. 8.

[12] In this type of financing the procedures followed by industrial banking companies are necessarily similar to those current among sales finance companies. For a discussion of the latter see National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices*, by W. C. Plummer and R. A Young (1940) pp. 104-21.

that financing agencies frequently run afoul of them is proof of the necessity for constant caution. When companies undertake to finance the time sale of merchandise directly with the customer, rather than through the dealer, the procedure is more nearly similar to that described above for the making of cash loans, though special adjustments have to be made to take account of the nature of the merchandise security.

Whatever the methods may be that are employed in judging a risk, the lending company cannot disregard the need for speed and for the maintenance of confidential relations with the borrower. Both of these factors introduce important elements of hazard into the business of granting credit, but the exigencies of competition require that they be recognized.

Collection Procedure

When a loan is made, a number of office records are prepared. Whether payments are to be direct or hypothecated in a special account, the dates when they are due are scheduled on the ledger card. In many offices loans are numbered according to due dates so that delinquency can be easily detected. The first two digits of the number 302614, for example, indicate that payments are due on the 30th of the month, while the remainder stand for the serial number of the loan. Other symbols may be added to the number to indicate the type of loan and other significant characteristics.

For collecting delinquent payments most companies employ a basically uniform method. First they send out form notices at appropriate intervals. Then, at a fairly early stage, they telephone the delinquent borrower, or perhaps send him a special letter signed by the manager, requesting payment or a consultation on the matter of a possible refinancing or extension of the loan. In some cases the adjustment

involves only a shifting of the due date or a change in the frequency of instalments.

Not all firms employ outside collecting agents. Nor do they all follow the same procedure with regard to comakers involved in delinquency. Some companies communicate with the comaker only when payment is long overdue, while others issue an early warning in order to protect themselves against complaints from this source. As in the transactions of other consumer credit agencies, the borrower's note generally contains an acceleration clause giving the lender the right, in case of default, to demand full payment before the contractual maturity date. When this privilege is exercised, legal action is usually necessitated.

COLLECTION EXPERIENCE

The collection experience of industrial banking companies is measured by data on delinquencies and losses. Charge-offs on loans are the primary source of loss but losses arise also from dealings in other types of assets. Delinquencies are expressed by a figure representing, for a particular date, the volume of loans delinquent for a specified length of time in percent of total loans outstanding on that date. The definition of what constitutes delinquency has never been standardized, though certain efforts have been made in this direction. Both The Morris Plan Corporation of America and the Morris Plan Bankers Association have urged Morris Plan companies to use a definition according to which "a loan is delinquent when no payment has been made for 4 weeks or more after due date." Some companies provide more detailed information by classifying delinquent accounts according to whether the period since due date was 30 to 60 days, 60 to 90 days, or 90 days or more. Since industrial banking companies invariably discount their loans, they are not confronted, as are personal finance companies, with the problem of dis-

tinguishing delinquency on principal from delinquency on charges.

The success of an industrial banking company in making collections on its loans depends to a considerable extent upon the management's ability to keep its delinquency record favorable. To the extent that this task calls for very skilful operation, the chances that competitive pressure will so increase as to reduce rates and profits are greatly diminished. It is of course impossible to measure statistically the differences in management ability in different firms, but some indication of such differences is contained in comparative figures on various companies' proportions of outstandings which, at a particular date, have been delinquent for a specified period of time. Such figures are presented in Table 19, for 29 members of the American Industrial Bank-

TABLE 19

DISTRIBUTION OF 29 INDUSTRIAL BANKING COMPANIES, DECEMBER 31, 1939, BY DELINQUENCY PERCENTAGE ON LOANS DELINQUENT 60 TO 90 DAYS AND 90 DAYS OR MORE[a]

Delinquency Percentage[b]	*On Loans Delinquent 60 to 90 Days*	*On Loans Delinquent 90 Days or More*
Under 1 6	13	13
1.6– 3.2	5	6
3 2– 4 8	3	3
4 8– 6 4	1	2
6.4– 8 0	2	0
8.0– 9 6	1	0
9.6–11 2	2	1
11.2 & over	2	4
TOTAL	29	29

[a] Based on data supplied by the American Industrial Bankers Association.
[b] Year-end outstandings on loans delinquent for specified period, in percent of total year-end loan outstandings. Delinquency is measured by the number of days from date payment was due. Each level is inclusive of the lower figure and exclusive of the higher

ers Association; these 29 companies include "non-investment" as well as "investment" firms, but for the present purpose the distinction between the two types is not significant. Although the wide disparity in delinquency experience revealed by this table may be partly due to reporting methods, it is unlikely that this factor explains the full range of the distribution. In spite of the diversity of experience here recorded, however, it is noteworthy that nearly half of the companies reported less than 1.6 percent of their total loans outstanding at the end of 1939 as having been delinquent for 60 to 90 days, and that the same number of companies reported this low percentage for loans delinquent 90 days or longer.

Table 20 supplies data on delinquency, and also on net charge-offs on loans, for 10 Morris Plan institutions during the period 1929-38. It is noteworthy that while delinquency percentages (pertaining to loans on which no payment was made for 4 weeks or more) were relatively high during the depression years, they had declined by 1935, and thereafter, to well under 2 percent. Net loan charge-offs (annual volume of loan charge-offs, minus recoveries), expressed in percent of the total annual loan volume, stood consistently at less than 1 percent. Supplementary data show that in the years 1933-35 loan volume increased about $13,500,000, but despite this increase net charge-offs declined from their peak of 0.97 to the very small figure of 0.08 percent, rising thereafter to slightly less than 0.3 percent in 1938. There is no consistent relation between year-to-year changes in net loan charge-offs and in delinquency, nor is there perceptible any close coordination between the net loan charge-off percentage for any one year and the delinquency percentage for the preceding year. It is true, however, that the year of highest delinquency, 1932, was followed by the year of greatest charge-offs.

These data are, on the whole, corroborated by the figures

TABLE 20

DELINQUENCY AND NET CHARGE-OFF PERCENTAGES ON LOANS MADE BY 10 MORRIS PLAN BANKING COMPANIES, 1929–38[a]

Year	*Delinquency Percentage*[b]	*Net Charge-off Percentage*[c]
1929	3.83	34
1930	4.12	.53
1931	3.43	.70
1932	4 38	61
1933	3.21	.97
1934	2.28	.55
1935	1 71	.08
1936	1.60	.17
1937	1.18	29
1938	1.45	.28

[a] Based on data supplied by The Morris Plan Corporation of America.

[b] Year-end outstandings on delinquent loans in percent of total year-end loan outstandings. A delinquent account is defined as one on which no payment has been made for 4 weeks or more after due date. Total outstandings for each year were estimated by computing, for 20 companies in which these 10 are included, the ratio of year-end outstandings to the volume of loans made during the year, and using this figure as a multiplier for the volume of loans made during each year by the 10 companies.

Delinquency percentages, expressed as above, are available also, for the years 1922-25 and 1929-32, on all Morris Plan banking companies. These figures, however, while of wider coverage, have not the advantage of pertaining to a single, unchanging group of firms:

1922	1.89	1929	2.46
1923	1.58	1930	2 93
1924	1.53	1931	3 43
1925	1.49	1932	4.89

[c] Volume of loan charge-offs made during the year, minus recoveries, in percent of the year's volume of loans made.

in Table 21, which shows, for 1930-36, the distribution of 26 members of the American Industrial Bankers Association, by net charge-off percentage on loans. In all years the majority of the companies had net charge-offs amounting to less than 1.6 percent of loan volume; on the other hand, a considerable number of companies had a higher proportion,

TABLE 21

DISTRIBUTION OF 26 INDUSTRIAL BANKING COMPANIES, 1930–36, BY NET CHARGE-OFF PERCENTAGE ON LOANS[a]

Net Charge-off Percentage[b]	1930	1931	1932	1933	1934	1935	1936
Under .0[c]	3	–	–	–	3	2	4
.0– .8	13	16	6	10	7	14	13
.8–1.6	6	3	10	7	9	5	6
1 6–2 4	4	3	2	3	3	1	2
2.4–3.2	–	3	3	1	–	2	–
3 2–4.0	–	1	3	3	2	–	–
4.0–4.8	–	–	2	–	–	–	–
4 8–5.6	–	–	–	1	–	1	–
5.6 & over	–	–	–	1	2	1	1
TOTAL	26	26	26	26	26	26	26

[a] Based on data supplied by the American Industrial Bankers Association.
[b] Volume of loan charge-offs made during the year, minus recoveries, in percent of the year's volume of loans made. Each level is inclusive of the lower figure and exclusive of the higher.
[c] A net charge-off percentage of less than zero indicates that the year's recoveries exceeded the year's volume of charge-offs.

some of them reaching as high as 5.6 percent or more. Further data from this group of companies indicate that on the majority of loans charged off the outstanding balance was between $50 and $125.

Data on gross as well as net charge-offs on loans, classified according to size of company, are to be found in Table 22, which has been prepared from reports made to the Federal Deposit Insurance Corporation by insured industrial banking companies. In this table, however, loan charge-offs are computed on the basis of total year-end outstandings in loans and discounts (net of repayments on instalment loans). As a result the percentages are higher than they would be if they were computed, as in Tables 20 and 21, on the basis of annual volume. It will be noted that, even with allowance

TABLE 22

GROSS AND NET CHARGE-OFF PERCENTAGES ON LOANS MADE BY INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY SIZE OF COMPANY[a]

Size of Company[b]	*1934*	*1935*	*1936*	*1937*	*1938*
Under $100,000					
Number	18	18	17	20	21
Gross charge-off percentage	2 28	1 83	.86	.44	59
Net charge-off percentage	1 72	1.26	.55	.27	42
$100,000–200,000					
Number	22	22	20	20	19
Gross charge-off percentage	2 67	1.55	1.22	.79	1.18
Net charge-off percentage	2 30	1.23	.64	.41	.62
$200,000–300,000					
Number	8	10	13	16	17
Gross charge-off percentage	2 57	1.63	1 02	1.10	1 42
Net charge-off percentage	1 72	68	.44	.44	1 06
$300,000–500,000					
Number	5	5	5	5	7
Gross charge-off percentage	1 09	84	.81	.86	.79
Net charge-off percentage	.57	24	02	.28	.43
$500,000–1,000,000					
Number	4	3	4	3	2
Gross charge-off percentage	1.75	.95	.95	.88	.64
Net charge-off percentage	78	.30	.42	29	.46
$1,000,000 & over					
Number	3	4	4	5	5
Gross charge-off percentage	2 67	1.57	1.18	78	70
Net charge-off percentage	1.31	.50	− 26	.09	.18
ALL COMPANIES					
Number	60	62	63	69	71
Gross charge-off percentage	2.31	1 42	1 09	.82	86
Net charge-off percentage	1 33	60	09	.21	40

[a] Based on data supplied by the Federal Deposit Insurance Corporation Figure on gross charge-offs represents volume of loan charge-offs made during the year, in percent of total year-end outstandings in loans and discounts (net of repayments on instalment loans). Figure on net charge-offs represents gross charge-offs minus recoveries, in percent of same total.

[b] As measured by total equity account (capital, surplus and undivided profits). Each level is inclusive of the lower figure and exclusive of the higher.

for this upward bias, the net charge-off percentages of the entire group of insured companies were in 1934 and 1935 considerably higher than might be expected from the data given in Table 20, and that in 1936 and 1937, in spite of their upward bias, they were actually lower than the corresponding figures in Table 20. This suggests that in 1934 and 1935, the first years after their admission to insurance, these companies followed a strict policy in writing off questionable loans, and subsequently made a high proportion of recoveries on the borderline paper.

This table indicates that in general the companies in the $100,000-300,000 groups (size measured by equity funds) had higher-than-average proportions of both gross and net loan charge-offs in all five years of the period 1934-38, and that companies in the $300,000-1,000,000 groups had lower-than-average proportions. The experience of the very small companies—those under $100,000—was, on the whole, better than average on gross charge-offs but worse than average on net charge-offs. In 1934-36 the largest companies—those of $1,000,000 or over—recorded gross charge-offs in higher proportion than all companies combined, but in all five years their net charge-off percentages were lower than average; in fact, in 1936 they had a negative percentage, indicating that in that year the volume of loan charge-offs was exceeded by the volume of recoveries.

Reserves against charge-off losses on loans vary considerably from one company to another. Information pertaining to the practice of 20 members of the American Industrial Bankers Association in 1937, and to that of 22 companies in 1938, shows that for the majority of these companies loss reserves were for amounts up to 1.5 percent of outstanding loans. Such a reserve is roughly in line with the average loss experience on loans.

Loss data on assets other than loans are presented in Table 23 for the same group of insured companies and the same

TABLE 23

GROSS AND NET LOSS PERCENTAGES ON ASSETS OTHER THAN LOANS HELD BY INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY SIZE OF COMPANY[a]

Size of Company[b]	*1934*	*1935*	*1936*	*1937*	*1938*
Under $100,000					
Number	18	18	17	20	21
Gross loss percentage	4.18	2.21	5.88	7.16	4.31
Net loss percentage	3.51	51	.27	3.31	2.72
$100,000–200,000					
Number	22	22	20	20	19
Gross loss percentage	2.04	3.15	4.16	6.01	11.06
Net loss percentage	1.04	.08	.09	3.26	9.70
$200,000–300,000					
Number	8	10	13	16	17
Gross loss percentage	.75	1.59	5.86	3.95	5.39
Net loss percentage	−2.26	−.48	3.82	2.59	−1.37
$300,000–500,000					
Number	5	5	5	5	7
Gross loss percentage	12.54	7.42	11.37	4.72	1.70
Net loss percentage	3.73	1.95	9.95	1.18	.50
$500,000–1,000,000					
Number	4	3	4	3	2
Gross loss percentage	5.93	1.60	7.84	10.47	8.49
Net loss percentage	−.60	−3.83	−1.41	10.01	.94
$1,000,000 & over					
Number	3	4	4	5	5
Gross loss percentage	4.05	7.03	7.99	8.21	5.44
Net loss percentage	2.33	4.78	5.72	6.32	1.76
ALL COMPANIES					
Number	60	62	63	69	71
Gross loss percentage	4.00	5.25	7.11	7.37	5.64
Net loss percentage	1.93	2.52	3.86	5.48	2.36

[a] Based on data supplied by the Federal Deposit Insurance Corporation. Figure on gross loss represents the year's volume of charge-offs on assets other than loans, losses on assets sold or exchanged (mainly investment securities) and additions to valuation allowances, in percent of total securities owned at the end of the year. Figure on net loss represents gross losses minus recoveries on charge-offs of assets other than loans, profits on assets sold or exchanged and reductions in valuation allowances, in percent of same total.

[b] As measured by total equity account (capital, surplus and undivided profits). Each level is inclusive of the lower figure and exclusive of the higher.

period. These figures show a record of collection experience quite different from that indicated in Table 22. With only two or three exceptions the smaller companies—all those having less than $300,000 in equity funds—had in all five years lower than average loss percentages on assets other than loans, both gross and net. The $300,000-1,000,000 companies show a very inconsistent record, and those of $1,000,000 and over were above average in all years except 1938. The type of loss covered in this table has greater significance for the group of insured companies than for most industrial banking companies, because the former have a larger proportion of their total assets invested in securities.

Table 24 provides, in regard to loans and all other assets, a comparison of the loss experience of three groups of institutions: insured industrial banking companies; insured commercial banks, not members of the Federal Reserve System, that have deposits of $2,000,000 or less; and all insured non-member commercial banks. The comparison of the first two groups is particularly important because the banking institutions they comprise are of about the same size and operate under similar legal conditions. The table reveals that of these two groups the industrial banking companies had—in every year except 1938, when there was very little difference—the lower net losses on loans (losses per $100 of total assets). In regard to net losses on assets other than loans the comparative experience of these two types of institutions was not so consistent. As for the group of smaller commercial banks in comparison with the entire group of insured non-member commercial banks, their total losses, both gross and net, were roughly similar in all years except 1935, when the smaller banks had substantially higher losses, per $100 of total assets, than were experienced by the entire group.

The importance of losses in relation to total expenses is indicated in Table 25, for insured industrial banking com-

TABLE 24

Total Gross and Net Losses per $100 of Total Assets for Three Groups of Banking Institutions, 1934–38[a]

Year	Type of Institution	Number of Institutions	Gross Losses[b]			Net Losses[c]		
			On Loans	All Other[d]	Total	On Loans	All Other[d]	Total
1934	All insured industrial banking companies	60	$1.26	$ .68	$1.94	$ .73	$ .33	$1.06
	Insured non-member commercial banks with deposits of $2,000,000 or less	7,004[e]	1 62	1.59	3 21	1 46	1.20	2.66
	All insured non-member commercial banks	7,379	1.61	1.58	3.19	1 48	1 11	2 59
1935	All insured industrial banking companies	62	.90	.53	1.43	.38	25	63
	Insured non-member commercial banks with deposits of $2,000,000 or less	7,066[f]	2.27	2 09	4 35	1 83	53	2.36
	All insured non-member commercial banks	7,508	.98	.84	1 82	.84	.15	99
1936	All insured industrial banking companies	63	69	68	1 37	.06	.37	.43
	Insured non-member commercial banks with deposits of $2,000,000 or less	7,005	.56	.61	1 17	.39	+.12	27
	All insured non-member commercial banks	7,460	.61	.76	1.37	.38	+ 09	29
1937	All insured industrial banking companies	69	.51	64	1 15	13	48	.61
	Insured non-member commercial banks with deposits of $2,000,000 or less	6,848	.43	.68	1 11	24	.26	.50
	All insured non-member commercial banks	7,351	.49	.78	1.27	.29	26	55
1938	All insured industrial banking companies	71	.51	.50	1 01	24	21	.45
	Insured non-member commercial banks with deposits of $2,000,000 or less	6,734	.37	.87	1 24	21	.48	69
	All insured non-member commercial banks	7,231	39	.97	1.36	24	.44	.68

panies of different sizes. On the whole, in each year of the period 1934-38, the ratio of losses to total expenses declined from the smallest companies to a low for those in the $300,000-500,000 size group (size measured by equity funds); the largest companies had the highest ratio in all years except 1938. In 1936-38 the ratios of the smallest companies were about as low as those of the $300,000-500,000 group, and in 1938 that of the companies with equity funds of $1,000,000 or over was approximately average. Except for these latter companies, losses on loans were far higher, during 1934-35, than those on other assets; after 1935 the differences between these two sources of expense were less conspicuous, in several instances the losses on loans even amounting to less than those on assets other than loans. In general, this table indicates very clearly that while losses may represent a relatively small proportion of the total volume of business handled, they are far from negligible as an element of expense, and that they might, if not kept at low levels, seriously impair a company's profitability.

---

[a] For industrial banking companies based on data supplied by the Federal Deposit Insurance Corporation. For commercial banks based on Federal Deposit Insurance Corporation, *Annual Report,* for the respective years, as follows: 1934, pp. 198 and 238; 1935, pp. 176 and 200, 1936, p. 168; 1937, p. 146, 1938, p. 218. For 1934 and 1935 data on banks with deposits of $2,000,000 or less had to be estimated, because in these years the number of banks in the various size groups that reported on losses differed from the number that reported on total assets. Estimates were derived by calculating, for each size group up to $2,000,000, the average loss for banks reporting on losses, and multiplying by the number of banks in that size group that reported on assets, the sums of the totals thus obtained were then related to the total assets of all banks having deposits of $2,000,000 or less. Data on commercial banks pertain only to those banks that were in operation during the entire year

[b] Gross charge-offs, losses on assets sold or exchanged and additions to valuation allowances.

[c] Gross losses minus recoveries on charge-offs, profits on assets sold or exchanged and reductions in valuation allowances.

[d] Mainly investment securities.

[e] Represents number of banks reporting on losses, 7,300 banks reported on assets.

[f] Represents number of banks reporting on losses, 7,275 banks reported on assets.

TABLE 25

Total Gross Losses of Insured Industrial Banking Companies in Percent of Total Expenses, 1934–38, by Size of Company[a]

Size of Company[b]	*1934*	*1935*	*1936*	*1937*	*1938*
Under $100,000					
Losses on loans	16.9	16.0	8.2	4.5	6.0
All other losses	6.1	3.2	6.5	6.6	4.6
Total	23.0	19.2	14.7	11.1	10.6
$100,000–200,000					
Losses on loans	18.8	12.8	11.6	8.1	9.8
All other losses	3.7	6.1	8.1	9.9	16.0
Total	22.5	18.9	19.7	18.0	25.8
$200,000–300,000					
Losses on loans	20.0	14.8	9.0	10.2	12.9
All other losses	.6	1.6	8.4	6.1	4.2
Total	20.6	16.4	17.4	16.3	17.1
$300,000–500,000					
Losses on loans	8.2	7.0	8.6	8.8	7.3
All other losses	5.6	2.8	4.1	1.9	3.7
Total	13.8	9.8	12.7	10.7	11.0
$500,000–1,000,000					
Losses on loans	13.2	9.5	9.1	7.4	6.5
All other losses	4.6	1.3	5.3	8.8	2.3
Total	17.8	10.8	14.4	16.2	8.8
$1,000,000 and over					
Losses on loans	15.6	13.5	11.1	7.7	6.9
All other losses	12.4	11.4	13.8	12.4	8.5
Total	28.0	24.9	24.9	20.1	15.4
All Companies					
Losses on loans	15.4	12.5	10.3	8.0	8.2
All other losses	8.3	7.3	10.1	10.1	8.0
Total	23.7	19.8	20.4	18.1	16.2

[a] Based on data supplied by the Federal Deposit Insurance Corporation. Total gross losses comprise gross charge-offs, losses on assets sold or exchanged and addition to valuation allowances. Total expenses comprise total gross losses plus total current operating expenses. The dollar volumes of these companies' total expenses are given in Table 44, pp. 156-57.

[b] As measured by total equity account (capital, surplus and undivided profits). Each level is inclusive of the lower figure and exclusive of the higher.

6

Credit Risk

IN ITS formulation of a credit policy an industrial banking company strives, first, to acquire a body of loans sufficiently large to assure effective utilization of its lending capacity, and, second, to select these loans so carefully that credit losses may be kept at a minimum. The problem of attaining these ends is complicated by the fact that loans are relatively small, so that decisions concerning a large number of borrowers are constantly to be made, and also by the fact that the decisions must be reached speedily. Credits, in such circumstances, must be passed within about twenty-four hours; on the other hand, bad-debt losses must be kept down to something like 1 percent of the volume of all loans made.

Except in regard to a loan secured by a savings passbook, no company can tell with certainty whether a borrower will pay his obligation promptly and in full or will involve the company in collection difficulties. Potential collection expense is thus expressed in terms of probabilities: a credit officer will reject an application of a given type if it appears to him, on the basis of whatever experience, fact and intuitive perception he can bring to bear on the situation, that the probable expense to be incurred is greater than the probable gross income to be earned on the loan.

When a borrower is an old customer with a tested credit record the problem of risk selection is greatly simplified, but with newcomers, whether customers or comakers, the credit officer's information is likely to be relatively incomplete and his responsibilities are augmented accordingly. Like other consumer credit agencies, the industrial banking com-

pany requires each loan applicant to fill out a form which provides information about himself, the loan he desires, and his comaker or whatever other security he offers. The same type of information, though less exhaustive in detail, is usually required of the comaker. This information is sought presumably because it provides either directly or indirectly certain facts concerning the borrower's characteristics—moral, personal, vocational and financial—which enable the credit officer to gauge what the payment record will probably be.

The moral characteristics of a borrower, or his willingness to pay, are indicated principally by his past payment record; his personal characteristics by age, sex, marital status, number of dependents and permanence of residence; his vocational characteristics by the industry in which he is employed, his position in that industry and the permanence of his employment; and his financial status by his income and by whatever information can be assembled as to his assets and liabilities. Other factors to be considered are the relation between the amount of the loan and the applicant's income, the use he intends to make of the funds, and the kind and quality of security he can provide to protect the loan. All of these factors are necessarily interrelated, and from the credit officer's point of view they are all to be weighed and considered in combination.

The present chapter attempts by statistical methods to ascertain the significance, as indicators of credit risk, of these various kinds of information supplied by customers of industrial banking companies.

PROCEDURE IN THE ANALYSIS OF CREDIT RISK

The data used in the preparation of this study were transcribed from a sample of 1,322 applications for loans which

were granted by 2 large Morris Plan banking companies and by 8 other industrial banking companies. The contributing institutions were asked to provide random samples of "good" and "bad" loans. Good loans were defined as those which paid out without collection difficulty, in other words, loans to borrowers who, on the basis of their payment record, would readily be granted another loan. Bad loans were held to be those which culminated in default, or involved legal action for collection, with the result that the borrower's record would clearly not warrant the extension of another loan.

The selection of the random samples was subject to only two conditions: first, that the good and bad loans should have been made within the same period of time; and second, that their distributions over that period should have been nearly identical. Although there is no certainty that the drawing was actually random in the strict sense of the term, the conclusions must necessarily be based on the assumption that it was. The information transcribed from the loan application blanks pertained only to financial, personal and vocational factors. Since no data were taken on the so-called moral factors affecting credit risk—past payment record, legal actions in which the applicant had been involved, the quality of references given, and the like—it has been impossible to estimate directly the statistical relevance of such information. Indications of moral risk may be inferred from the data only in so far as they are suggested by such characteristics as permanence of residence and occupation.

The data obtained from loan application blanks are presented here in the form of tables giving the distributions of the good-loan and bad-loan samples according to the several characteristics of the borrowers. These tabulations not only indicate the relative significance of these various factors as indicators of credit risk, but also provide the best available description of the characteristics of the market for

industrial loans. In this latter connection only the distributions of the good-loan sample are relevant, for the great majority of industrial banking company's customers do liquidate their obligations as scheduled.

The good-loan and bad-loan samples used in this analysis are almost equal in size. Thus the former constitutes a much smaller proportion than the latter of the total group of borrowers which it represents. This fact does not, however, detract from the representativeness of the samples, which is conditioned by the absolute number of cases that each contains, and not by this number's ratio to the whole body of comparable loans.

It is essential in an analysis of this kind to introduce certain checks against sampling errors. The main problem is to determine whether, for any particular borrower characteristic, the difference between the distributions of the two samples is a real difference between good and bad loans, taken as a whole, or is merely the result of sampling error. In the present study the chi-square test of statistical significance has been used for this purpose.[1]

In each of the tables in this chapter variation in risk experience among different borrower classes is measured by what is termed an "index of bad-loan experience." This index is the ratio of the percentage of bad loans in any class to the percentage of good loans in the same class. In any particular table the ratio, or index, for all classes combined would be 1 (100 percent to 100 percent); thus a ratio of more than 1 for any class indicates that loans made to borrowers in that class are worse-than-average risks, and a ratio of less than 1 indicates that such loans are better-than-average risks.

The loans to which this analysis applies have been di-

[1] A 1 percent standard of statistical significance has been used. For a more detailed discussion of the chi-square test see National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit*, by John M. Chapman and Associates (1940) pp. 114-15.

vided into three groups, according to the source of the data. On one group, Sample A, information was supplied by an industrial banking company in a metropolitan center of the Middle Atlantic region; on another, Sample B, the data came from a large industrial banking company in the South Atlantic region; the third group, Sample C, is a combination of eight small samples submitted by relatively small companies operating in as many different cities and seven states. In each of the tables figures are also given for the three samples combined; this is the only grouping for which the index of bad-loan experience is computed.

Two main qualifications should be mentioned in regard to the following analysis. In the first place, the loan samples, both good and bad, pertain of necessity only to persons whose loan applications have been approved, and therefore the data cannot be regarded as indicating anything about the various characteristics of loan applicants as a whole. In the second place, it cannot be concluded that it is unwise to make loans to all persons within any particular class that shows a considerably worse-than-average index of bad-loan experience. It is obvious that such a policy would eliminate some desirable as well as some undesirable borrowers, for no class is so bad that it contains only defaulting customers. In a sample of good loans only 2 percent of the borrowers might be in the age group of 21-25 years, and in a sample of bad loans 15 percent; but if all applicants of this age were rejected, while in the total group of applicants the good might be expected to outnumber the bad by 100 to 1, there would be 13 times as many good loans as bad loans refused.

The difference between the percentages of bad loans and the percentages of good loans in the entire group of classes containing worse-than-average risks—a difference which is equal to that between the percentages of good and bad loans in the average and better-than-average group of classes—is

the "index of distribution difference." This index measures the relative efficiency of each borrower characteristic as an indicator of credit risk. If the index is 100 the better-than-average group contains all the good loans and the worse-than-average all the bad loans, while if the index is 0 the good and bad loans have exactly the same distribution among the various classes. If the index is 100 rejection of loan applications in the worse-than-average classes would eliminate only bad loans, while if the index is 0, elimination of loans in any class would mean the rejection of equal percentages of good and of bad; but since good loans heavily outweigh the bad, such a procedure would result in the elimination of a much larger *number* of good than of bad loans. The closer the index of distribution difference stands to 100, the greater is the difference between the percentage of bad loans and the percentage of good loans that would be eliminated if a worse-than-average class were rejected.

BORROWER CHARACTERISTICS AS FACTORS IN CREDIT RISK

Personal Characteristics

As already noted, the samples of good and bad loans provide data on the following personal characteristics of borrowers: age, sex, marital status, number of dependents and duration of residence. Percentage distributions of the samples according to these five characteristics, and indices of bad-loan experience for each factor, are presented in Tables 26, 27, 28 and 29.

Table 26 indicates that a somewhat higher proportion of bad-loan than of good-loan borrowers from industrial banking companies are under 40 years of age, and that a considerably higher proportion of good-loan than of bad-loan borrowers are over 50. The index of bad-loan experience increases fairly consistently from 0.43 for this latter age

TABLE 26

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY AGE OF BORROWER[a]

Sample	Age of Borrower								Number of Loans	
	21–25 Years	26–30 Years	31–35 Years	36–40 Years	41–45 Years	46–50 Years	Over 50 Years	Total	Report-ing	Not Re-porting
A Good	5 3	13 6	20.2	15 4	14 0	14 0	17.5	100 0	228	9
Bad	7 1	21.2	21.7	18 6	12 4	7.5	11 5	100 0	226	8
B Good	12.7	16.6	16 1	10 7	10.2	8 8	24.9	100 0	205	36
Bad	15 9	17.4	20 4	14 4	12 9	8 5	10 5	100 0	201	36
C Good	11.7	19 9	12.9	15 2	14 0	7 0	19.3	100 0	171	14
Bad	19.2	23.6	16 5	18 1	11 0	7.7	3.9	100.0	182	6
ALL SAMPLES										
Good	9 6	16.4	16.7	13 7	12 8	10.3	20.5	100.0	604	59
Bad	13 6	20 7	19 7	17.1	12 1	7 9	8 9	100 0	609	50
Index of bad-loan experience[b]	1 42	1 26	1 18	1 25	.95	.77	.43	1 00		
Index of distribution difference[c]								14.7		

[a] Based on information contained in 1,322 applications for loans, granted by an industrial banking company in a metropolitan center of the Middle Atlantic region (Sample A), an industrial banking company in the South Atlantic region (Sample B), and eight companies operating in eight different cities and seven states (Sample C).

[b] Ratio of bad-loan percentage to good-loan percentage. A ratio of more than 1 indicates worse-than-average experience, and a ratio of less than 1 indicates better-than-average experience

[c] The difference between the bad-loan percentages and the good-loan percentages in the entire group of classes containing worse-than-average risks The closer this index stands to 100, the greater is the percentage of bad loans, as compared with good loans, that would be eliminated if a worse-than-average class were rejected.

TABLE 27

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY MARITAL STATUS AND SEX OF BORROWER[a]

Sample	*Married*		*Single*		*Others*[b]	*Total*	*Number of Loans*
	Men	Women	Men	Women			
A Good	59 5	8.0	12.7	14.3	5.5	100.0	237
Bad	62 4	4.3	23.5	5.1	4.7	100.0	234
B Good	51.1	11 2	9 1	8 7	19 9	100.0	241
Bad	56.1	5 5	9 7	3 0	25.7	100.0	237
C Good	72.4	2.2	10.8	4.9	9.7	100.0	185
Bad	70 2	2.7	16.5	3.7	6 9	100.0	188
ALL SAMPLES							
Good	60.0	7.5	10.9	9.7	11 9	100.0	663
Bad	62.4	4.2	16.5	4.0	12 9	100.0	659
Index of bad-loan experience	1 04	.56	1.51	41	1.08	1 00	
Index of distribution difference						9.0	

[a] See footnotes to Table 26, p. 125.
[b] Includes persons widowed, divorced, separated or not reporting.

group to a high of 1.42 for borrowers between 21 and 25. This tendency is too marked to be attributed simply to errors in the drawing of the samples; also, it agrees in general with a tendency observed in regard to commercial bank personal loan borrowers.[2] It should be noted, however, that the apparent relation of borrower's age to bad-loan experience may be less a reflection of the direct effect of age on credit risk than of the indirect effect of other related factors such as occupation, income, marital status and the like.

Table 27, which presents distributions of the loan sam-

[2] *Ibid.*, Table 27, p. 120.

ples according to the sex and marital status of borrowers, suggests that well over half of all borrowers are married men and that about one-tenth are single men, while the proportions of married and single female borrowers are on the whole about equal. Married men, as a group, seem to have an approximately average record on loan performance, as is indicated by their index of 1.04. Single men, on the other hand, have an index of 1.51, which is somewhat worse than average. The indices for women, both married and single, show that they are better-than-average risks. The variations displayed in Table 27 cannot be considered to reveal a marked difference in the credit records of married and single persons, but they are sufficient to indicate a significant difference in credit experience on loans to men as compared with loans to women. This finding too is borne out by data on personal loans extended by commercial banks[3] The better-than-average risk experience for women as compared with men may be attributable, however, to certain vocational characteristics of women borrowers. As will be shown below, credit experience on loans to wage-earners is worse than average, and the fact that few women borrowers are found in this class serves as a partial explanation of the findings drawn from Table 27.

It appears from Table 28 that the number of a borrower's dependents bears no significant relation to credit risk experience, and data on personal loans extended by commercial banks point to the same conclusion.[4] This does not mean, however, that the number of a person's dependents is a factor that can be ignored in selecting credit risks. Rather, it suggests that credit officials, in deciding upon applications for loans, give this factor sufficient consideration to make it relatively insignificant as an autonomous criterion.

[3] *Ibid.,* Table 28, p. 121.
[4] *Ibid,* Table 29, p. 122.

TABLE 28

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY NUMBER OF BORROWER'S DEPENDENTS[a]

Sample		*Number of Dependents*						*Number of Loans*	
		None	One	Two	Three	Four or More	Total	Reporting	Not Reporting
A	Good	28.1	28.5	17.5	16 7	9 2	100 0	228	9
	Bad	31.4	27.0	17 7	15 5	8 4	100.0	226	8
B	Good	30 6	34 4	14 8	9.3	10.9	100.0	183	58
	Bad	28 6	31 5	19.1	12.9	7.9	100 0	178	59
C	Good	12 1	34.2	28 2	15.4	10.1	100.0	149	36
	Bad	13.6	28.6	21.4	22.8	13 6	100.0	154	34
ALL SAMPLES									
	Good	24.6	32.0	19.5	13 9	10.0	100 0	560	103
	Bad	25.6	28 8	19 2	16 7	9 7	100.0	558	101
Index of bad-loan experience		1 04	90	.98	1 20	.97	1.00		
Index of distribution difference							3 8		

[a] See footnotes to Table 26, p. 125.

Table 29 indicates that the great majority of borrowers have lived at least 3 years in the same place. In Samples B and C only a handful of borrowers reported a residence of less than 3 years, and while it may be assumed that some proportion of the relatively high numbers not reporting at all on this item would fall in these classes of shorter residence, it is most unlikely that there would be enough to contradict the pattern noted here. It is not clear from an examination of the loan data whether the number of years given refers to length of residence in the same city or

TABLE 29

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY DURATION OF BORROWER'S RESIDENCE[a]

Sample	Years of Residence[b]							Number of Loans	
	Under 1	1–2	2–3	3–6	6–10	10 or More	Total	Reporting	Not Reporting
A Good	5.3	4 0	8 0	26 2	20 9	35.6	100.0	225	12
Bad	2 8	10.2	11.2	27 0	27.4	21 4	100 0	215	19
B Good	.	..		11 5[c]	7.1	81 4	100.0	113	128
Bad	.	..	.	25.0[c]	13 9	61.1	100.0	72	165
C Good	.		.	10 3[c]	6 2	83 5	100.0	97	88
Bad	..	..	..	34 4[c]	6 2	59.4	100 0	96	92
ALL SAMPLES									
Good	3 4	2.8	5.7	15 9	14 0	58.2	100 0	435	228
Bad	3.1	8.6	8 9	21.4	19 6	38 4	100.0	383	276
Index of bad-loan experience	.91	3 07	1.56	1.35	1 40	66	1.00		
Index of distribution difference							20.1		

[a] See footnotes to Table 26, p. 125.

[b] Number of years of residence in the same city. Each level is inclusive of the lower figure and exclusive of the higher.

[c] Includes all borrowers who reported a residence of less than 6 years. Distribution of borrowers in the first three classes was not computed because of the small number reporting, these three classes were not consolidated, however, in computing the distribution of all samples or in computing the index of bad-loan experience.

at the same address, but it is obviously safe to assume the former meaning. Thus the distributions of all three samples indicate that persons who have resided 10 years or more in the same city are better-than-average risks. This conclusion too might have to be modified if information were available from the non-reporting borrowers, but that it is fairly reliable is suggested by the fact that also in an analysis of commercial bank personal loan customers the index of bad-loan experience was found to vary inversely with duration of residence.[5]

Vocational Characteristics

The data on vocation which the samples make available for analysis pertain to the nature of the borrower's occupation, the industry in which he is employed and the permanence of his occupational status. Such factors are, of course, like personal, moral and financial characteristics of industrial banking company borrowers, closely interrelated with other borrower data.

Certain difficulties are encountered in attempting to classify these loan samples according to the borrower's occupational and industrial status. In many instances this information is not reported on the loan application blank and in other cases the statements are ambiguous. Some of the loans carrying an ambiguous statement can be assigned to particular classes, but in general the meagerness of information leads to the assignment of a relatively large proportion of the loans to a miscellaneous category. Moreover, since the total sample of loans is small it is necessary to classify borrowers into relatively few, and therefore not very specific, industrial and occupational groups.

The occupational distribution of the samples, presented in Table 30, indicates that clerical and wage-earning groups provide the majority of industrial banking company bor-

[5] *Ibid.*, Table 30, p. 122.

TABLE 30

Percentage Distribution of Good-Loan and Bad-Loan Samples, by Occupation of Borrower[a]

Sample	Professional Workers	Clerical Workers: Office Workers	Clerical Workers: Outside Salesmen	Clerical Workers: Other	Clerical Workers: Total	Proprietors	Managers and Officials	Wage-Earners: Skilled Labor	Wage-Earners: Other	Miscellaneous[b]	Total	Number of Loans
A Good	16.0	10.1	5.1	11.4	26.6	19 5	13.9	6 3	8.0	9.7	100 0	237
Bad	10 3	6.0	6.4	16.7	29 1	13 6	15 8	6.0	18 8	6 4	100 0	234
B Good	6.6	17.4	2 9	14 1	34 4	6 7	7.1	15 3	13.7	16 2	100 0	241
Bad	5.5	13.9	10 6	8 8	33.3	10 2	7 6	14.3	17.7	11 4	100 0	237
C Good	4.3	11.4	6 5	10 8	28 7	8.7	6 5	22.7	20.5	8.6	100 0	185
Bad	2 7	6 9	12.2	9 6	28 7	13.8	6 4	19 7	24.5	4.2	100.0	188
All Samples												
Good	9 3	13.1	4 7	12.2	30 0	11 8	9.3	14.2	13 6	11 8	100 0	663
Bad	6.4	9 1	9 6	11.8	30.5	12 4	10.2	12.9	20.0	7 6	100 0	659
Index of bad-loan experience	67	69	2 04	97	1.02	1.05	1.10	91	1 47	64	1 00	
Index of distribution difference											12 8	

[a] See footnotes to Table 26, p. 125.
[b] Includes those not reporting occupation.

rowers, each of these occupations accounting for about 30 percent of the total number of borrowers in these samples. In 1935-36, according to estimates of the National Resources Planning Board, wage-earners constituted 52.9 percent of the entire non-farm population, and clerical workers 20.3 percent.[6] Thus the industrial banking companies covered in these samples appear to have a larger proportion of clerical workers in their total group of borrowers, and a considerably lower proportion of wage-earners, than is characteristic of the total non-farm population.

The indices of bad-loan experience suggest that the professional class, the clerical class of typists, stenographers, accountants and other office workers, and the group of miscellaneous occupations are better-than-average risks, and that the clerical group of outside salesmen and commercial representatives is a substantially worse-than-average credit risk; wage-earners other than skilled laborers are also worse than average, though less notably. The other classes—skilled labor, managers and officials, proprietors and the clerical workers as a unit group—appear to have about an average record of loan performance. Comparable analysis of commercial bank personal loan samples confirms these findings, on the whole.[7]

In Table 31, which presents distributions of the samples according to the borrower's industrial affiliation, it has been necessary to assign an even greater proportion of the loans to the category of miscellaneous. Public service, with an index of 0.47, is the only industrial group which this analysis indicates as consisting of substantially better-than-average risks. The group of miscellaneous transportation workers, with an index of 2.21, has a credit standing that is much worse than average. Other industrial classes which are relatively important, in terms of their ratios to the total numbers

[6] National Resources Planning Board, *Consumer Incomes in the United States* (1938) Table 10B, p. 97.

TABLE 31

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY INDUSTRIAL AFFILIATION OF BORROWER[a]

Sample	*Utilities*[b]	*Professional Service*	*Public Service*	Trade: Wholesale and Retail	Trade: Other[c]	Trade: Total	*Manufacturing*	*Service Trades*[d]	*Miscellaneous Transportation*[e]	*Building Trades*[f]	*Miscellaneous*[g]	*Total*	*Number of Loans*
A Good	5.5	6.7	13.1	16.9	17.3	34.2	14.8	8.0	2.5	.4	14.8	100.0	237
Bad	14.5	6.4	4.7	13.2	17.9	31.1	14.1	10.7	4.3	1.3	12.9	100.0	234
B Good	12.9	2.1	14.9	9.5	12.1	21.6	16.6	5.8	2.5	2.9	20.7	100.0	241
Bad	14.3	2.5	9.3	11.8	12.6	24.4	18.6	5.9	3.8	3.0	18.2	100.0	237
C Good	14.1	2.2	8.6	10.3	10.3	20.6	28.6	4.9	2.1	3.2	15.7	100.0	185
Bad	11.2	2.1	3.2	7.5	11.7	19.2	34.0	7.5	8.5	.5	13.8	100.0	188
ALL SAMPLES													
Good	10.6	3.8	12.5	12.4	13.4	25.8	19.3	6.3	2.4	2.1	17.2	100.0	663
Bad	13.5	3.8	5.9	11.1	14.3	25.4	21.4	8.0	5.3	1.7	15.0	100.0	659
Index of bad-loan experience	1.27	1.00	.47	.90	1.07	.98	1.11	1.27	2.21	.81	.87	1.00	
Index of distribution difference												10.5	

[a] See footnotes to Table 26, p. 125.

[b] Railroad, bus and steamship transportation, communication (other than postal), gas and electric utilities.

[c] Real estate, insurance, advertising, printing and publishing, banking and brokerage, etc

[d] Domestic and personal services: laundries, cleaning, hotels, restaurants, barbers, etc.

[e] Taxi and trucking service, garage service, auto repair, filling stations, etc.

[f] Building and maintenance of roads, shipbuilding, etc.

[g] Includes those not reporting industrial affiliation.

in the sample—for example, manufacturing, trade and the miscellaneous group—are all nearly average-risk groups.

Table 32 gives the percentage distributions of the good and bad loans in the various samples according to the number of years the borrower has been employed in his present position. This tabulation suggests about the same conclusions as did Table 29, on duration of residence; it conforms also with findings derived from commercial bank personal loan samples.[8] Borrowers whose tenure of employment is 10 years or more appear to be notably better-than-average risks, their index of bad-loan experience being only 0.53; from that level the index rises consistently to 2.24 for those employed in their present positions for less than a year. The interdependence of different borrower characteristics is well illustrated by duration of employment: younger persons tend to fall in the shorter tenure groups, and older persons in the longer tenure groups, and, as was shown in Table 26, younger borrowers have a considerably worse record of loan performance than older borrowers.

Financial Characteristics

Distribution of the loans according to borrower income, shown in Table 33, reveals marked differences in the three individual samples. In Sample A only 3 percent, while in Samples B and C nearly one-fourth, of the borrowers had incomes of less than $1200 a year. More than 80 percent of the borrowers in Samples B and C had incomes of less than $2400, while well under half of those in Sample A were in this class. It might be noted also that Sample A borrowers, in contrast to those in Samples B and C, are fairly evenly distributed through the higher income levels.

The income-level variation of the index of bad-loan experience is not statistically significant. This is the same conclusion as that drawn from an analysis of commercial bank

[8] *Ibid.*, Table 33, p. 127.

TABLE 32

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY DURATION OF BORROWER'S EMPLOYMENT[a]

Sample	*Years of Employment*[b]							*Number of Loans*	
	Under 1	1–2	2–3	3–6	6–10	10 or More	Total	Reporting	Not Reporting
A Good	5.5	6.4	3 2	19 1	18 6	47.2	100 0	220	17
Bad	6.6	10.9	8 0	25.9	25 9	22 7	100 0	212	22
B Good	4.3	5 5	6 1	15.4	19 6	49.1	100 0	163	78
Bad	17.8	9 2	7.5	20.1	16.1	29.3	100 0	174	63
C Good	5.5	11.0	7 3	18 3	18 3	39 6	100 0	164	21
Bad	10.7	21.3	13.6	19 5	13.6	21 3	100 0	169	19
ALL SAMPLES									
Good	5.1	7.5	5.3	17 8	18.8	45 5	100.0	547	116
Bad	11.4	13.5	9 5	22 2	19.1	24.3	100 0	555	104
Index of bad-loan experience	2 24	1.80	1 79	1 25	1 02	.53	1.00		
Index of distribution difference							21.2		

[a] See footnotes to Table 26, p 125

[b] Number of years of employment in present position. Each level is inclusive of the lower figure and exclusive of the higher.

TABLE 33

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY INCOME OF BORROWER[a]

Sample	Annual Income[b]								Number of Loans	
	Under $1200	$1200–1800	$1800–2400	$2400–3000	$3000–3600	$3600–4800	$4800 and Over	Total	Reporting	Not Reporting
A Good	3.2	12 4	27.7	15 7	15 2	10.1	15 7	100 0	217	20
Bad	2.9	17.5	33 0	16.0	11 2	10.2	9.2	100.0	206	28
B Good	22.7	32 0	26 7	9.8	5 3	2 2	1.3	100 0	225	16
Bad	28 4	28 9	21 6	9 3	5.9	3.4	2.5	100 0	204	33
C Good	23.8	30 8	29.1	7 6	4.6	2.9	1.2	100 0	172	13
Bad	21.1	40 0	20.0	12 6	2 3	2 9	1 1	100.0	175	13
ALL SAMPLES										
Good	16 1	24 8	27 7	11 2	8 6	5 2	6 4	100 0	614	49
Bad	17.3	28 2	25.1	12 7	6 7	5.6	4.4	100.0	585	74
Index of bad-loan experience	1 07	1.14	.91	1.13	.78	1 08	.69	1 00		
Index of distribution difference								6 5		

[a] See footnotes to Table 26, p 125

[b] Each level is inclusive of the lower figure and exclusive of the higher.

personal loans,[9] but it is contrary to the findings arrived at in studies of personal finance company and sales finance company credit experience.[10] An important reason for the smaller significance of borrower's income in analyses of banking credit experience is the fact that banking institutions, in contrast to personal finance companies, extend the great majority of their personal loans on comaker or single-name notes, without collateral security; sales finance companies, of course, deal almost entirely in retail instalment credit, for which the commodity purchased serves as security. Thus the banking institutions are constrained to give greater emphasis to the applicant's financial position, and it may be assumed that risk selection at the time of application eliminates the most questionable cases. Factors that indicate the stability of income—such as the nature of a borrower's occupation and the duration of his employment—are therefore revealed as more significant criteria for an analysis of actual experience than is income itself.

In view of the differences in the income distributions of the three individual samples it is not surprising to find, in Table 34, substantial variations also in regard to size of loan. Sample A, which has the smallest percentage of low-income borrowers, has also the smallest percentage of loans amounting to less than $100. The indices of bad-loan experience do not reveal a significant relationship between size of loan and credit risk, except perhaps for loans of less than $100, which seem to be associated with a worse-than-average credit experience. This result accords with that found for commercial bank personal loans,[11] but it is at variance with the finding in regard to personal finance com-

[9] *Ibid.*, Table 34, p. 128.

[10] National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (1940) pp. 96-99, and *Sales Finance Companies and Their Credit Practices*, by W. C. Plummer and R. A. Young (1940) pp 180-83.

[11] John M. Chapman and Associates, *op. cit.*, Table 37, p. 133.

TABLE 34

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY AMOUNT OF NOTE[a]

Sample	Amount of Note[b]								Number of Loans	
	Under $100	$100–200	$200–300	$300–400	$400–500	$500–1000	$1000 and Over	Total	Reporting	Not Reporting
A Good	1.7	28.3	18.6	20.2	6.7	17.3	7.2	100.0	237	.
Bad	6.1	35.5	21.7	17.7	4.3	13.0	1.7	100.0	231	3
B Good	13.3	44.2	19.6	12.5	2.1	8.3	.	100.0	240	1
Bad	18.1	35.0	20.3	10.6	4.6	11.4		100.0	237	..
C Good	14.1	51.3	19.5	10.8	4.3	..	.	100.0	185	..
Bad	21.5	40.9	19.4	11.8	6.4	.	..	100.0	186	2
ALL SAMPLES										
Good	9.4	40.5	19.2	14.8	3.3	9.5	3.3	100.0	662	1
Bad	14.8	36.9	20.5	13.5	4.3	8.8	1.2	100.0	654	5
Index of bad-loan experience	1.57	.91	1.07	91	1.30	93	.36	1.00		
Index of distribution difference								7.7		

[a] See footnotes to Table 26, p. 125.
[b] Each level is inclusive of the lower figure and exclusive of the higher

pany credit risk.[12] In the latter study it was found that credit experience is best on loans of less than $100 and progressively worse on loans of larger size, except those of $300.

The relationship between the amount of a loan and the borrower's income might be expected to be of some significance as an indicator of credit risk, but Table 35 does not bear out this hypothesis. It appears, indeed, that the best credit experience is associated with loans that amount to 20 percent or more of borrower's income. These findings do not mean, however, that the note-to-income ratio may be disregarded. What was pointed out in regard to income and number of dependents seems to be true here too: in the original selection of borrowers this factor was given sufficient weight to make it relatively insignificant as an explanation of actual credit losses. That a fairly conservative credit policy was followed is evident also from the fact that roughly three-fourths of the borrowers received loans amounting to less than 15 percent of their income.

Table 36 presents data on all the items of borrower assets and liabilities on which information was available from the samples. Each of the three asset items reported on—bank account, life insurance and real estate—appears to be significantly related to credit experience, and this finding is confirmed by the study of commercial bank personal loans.[13] Samples A and C provide information on the borrower's liability status with regard to other instalment accounts, but since the distributions of their good and bad loans are noticeably dissimilar it is unlikely that any weight can be attached to this credit factor. Their composite index of bad-loan experience does show that borrowers who were indebted on instalment accounts when they were granted their loans were worse-than-average risks, and that borrowers not so encum-

[12] Ralph A. Young and Associates, *op. cit.*, pp. 103-05.
[13] John M. Chapman and Associates, *op. cit.*, Table 36, p. 131.

TABLE 35

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY AMOUNT OF NOTE IN PERCENT OF BORROWER'S ANNUAL INCOME[a]

Sample	*Amount of Note in Percent of Borrower's Income*						*Number of Loans*	
	Under 5 Percent	5–9 Percent	10–14 Percent	15–19 Percent	20 Percent or More	Total	Reporting	Not Reporting
A Good	5.1	43 0	29 2	10.2	12.5	100 0	216	21
Bad	11.8	43 6	29.9	10.0	4 7	100.0	211	23
B Good	13.9	35 4	24.7	10.8	15.2	100 0	223	18
Bad	10.7	38 8	22.9	13 3	14.3	100 0	196	41
C Good	12.4	38.8	28 2	11.8	8 8	100.0	170	15
Bad	16.3	41.3	18 6	13 9	9 9	100 0	172	16
ALL SAMPLES								
Good	10.3	39.1	27 3	10.8	12.5	100 0	609	54
Bad	12 8	41.3	24.2	12 2	9.5	100.0	579	80
Index of bad-loan experience	1.24	1 06	89	1 13	.76	1.00		
Index of distribution difference						6.1		

[a] See footnotes to Table 26, p. 125.

TABLE 36

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY SELECTED ASSET AND LIABILITY ITEMS OF BORROWER[a]

Sample	Bank Account			Life Insurance			Real Estate			Instalment Account		
	Yes	No	Number[b]	Yes	No	Number[b]	Yes	No[c]	Number[d]	Yes	No	Number[b]
A Good	34.2	65.8	234	77.2	22.8	237	24.5	75.5	237	17.4	82.6	236
Bad	19.2	80.8	229	71.5	28.5	228	10.7	89.3	234	13.4	86.6	231
B Good	..	..	.	..	..	.	22.8	77.2	241	..	..	.
Bad	..	..	..	.	..	..	16.9	83.1	237	..	..	.
C Good	33.3	66.7	84	89.4	10.6	113	23.8	76.2	185	43.3	56.7	104
Bad	20.7	79.3	92	75.4	24.6	114	14.4	85.6	188	71.0	29.0	124
ALL SAMPLES												
Good	34.0	66.0	318	81.1	18.9	350	23.7	76.3	663	25.3	74.7	340
Bad	19.6	80.4	321	72.8	27.2	342	14.0	86.0	659	33.5	66.5	355
Index of bad-loan experience	.58	1.22		.90	1.44		.59	1.13		1.32	8.9	
Index of distribution difference		14.4			8.3			9.7			8.2	

[a] See footnotes to Table 26, p. 125.
[b] Number of those reporting information on this item.
[c] Includes those not reporting on real estate holdings.
[d] Total number of loans in sample

bered were better-than-average risks, but the variation is not sufficiently marked to constitute an important finding.

LOAN CHARACTERISTICS AS FACTORS IN CREDIT RISK

Loan size as a possible risk factor has already been discussed in connection with the relation of income to credit experience. There are other loan characteristics, however—type of security, length of contract and, less directly, intended use of funds—which are pertinent to an analysis of risk.

TABLE 37

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY TYPE OF SECURITY[a]

Sample		*Single-Name*	*1 Co-maker*	*2 Co-makers*	*3 or More Co-makers*	*Other*[b]	*Total*	*Number of Loans*
A	Good	17.3	11.8	46.8	24.1	.	100.0	237
	Bad	18.0	9.8	48.3	22.2	1.7	100.0	234
B	Good	11.6	37.8	40.2	7.5	2.9	100.0	241
	Bad	12.7	30.4	33.3	18.6	5.0	100.0	237
C	Good	14.1	12.4	56.8	11.3	5.4	100.0	185
	Bad	1.1	17.6	48.9	22.3	10.1	100.0	188
ALL SAMPLES								
	Good	14.3	21.4	47.2	14.5	2.6	100.0	663
	Bad	11.2	19.4	43.1	21.0	5.3	100.0	659
Index of bad-loan experience		.78	.91	.91	1.45	2.04	1.00	
Index of distribution difference							9.2	

[a] See footnotes to Table 26, p. 125.

[b] Includes those not reporting on type of security.

Table 37 shows that in Samples A and B single-name notes appeared in the good- and bad-loan groups with about equal frequency, and that in Sample C they appeared much more frequently in the good-loan than in the bad-loan group. This finding is particularly interesting in view of the current tendency for industrial banking companies to increase the proportion of their total loans extended on the sole security of the maker's name.[14] It would appear that when such loans are made, sufficient care is taken in the choice of risks to yield an average, or even a much better-than-average, credit experience. With regard to comaker notes all that can be said on the basis of the present samples is that loans secured by one or two comakers constitute the bulk of the loans in each individual sample, and that credit experience tends to become worse as the number of comakers increases. These general findings are confirmed by the study of commercial bank personal loans.[15]

Table 38 presents a distribution of the samples according to the number of months allowed for repayment. Notes contracted to run for 12 months account for practically all of the loans in Sample A and for about 75 percent of the loans in the three samples combined. Analysis of the data in this table reveals no significant relation between credit experience and contractual maturity.

It is customary to require a borrower to indicate on his application the use to which the proceeds of the loan are to be put. It is difficult, however, to make a satisfactory classification of loans according to this characteristic, because borrowers' statements as to the intended use of the funds may be unreliable and are often ambiguous. Also, in many

[14] In some cases single-name notes are "husband and wife" notes. The basic characteristic of the "single-name" loan is that it is secured by the name of only one income-earner.

[15] John M. Chapman and Associates, *op cit.*, Table 38, p. 134.

TABLE 38

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY LENGTH OF LOAN CONTRACT[a]

Sample		Length of Contract						Number of Loans	
		1–6 Mos	7–11 Mos.	12 Mos.	13–17 Mos.	Over 17 Mos	Total	Reporting	Not Reporting
A	Good		4	99 2	4	..	100 0	237	..
	Bad	1 7		97 9	4	.	100.0	231	3
B	Good	7.5	11.6	61 0	6 6	13 3	100 0	241	.
	Bad	7 0	13 2	52 6	10 5	16.7	100.0	228	9
C	Good	3 4	19 2	64 4	2 3	10 7	100.0	177	8
	Bad	5 6	10 1	71.4	1 7	11 2	100 0	178	10
ALL SAMPLES									
	Good	3 7	9.6	75 7	3 2	7 8	100 0	655	8
	Bad	4.7	7.5	74.3	4.4	9.1	100 0	637	22
Index of bad-loan experience		1 27	78	98	1 38	1 17	1 00		
Index of distribution difference							3.5		

[a] See footnotes to Table 26, p. 125

instances the loan is applied to several different purposes. Thus the classification in Table 39 is not to be taken too literally. From the data here presented it seems that loans to finance tax payments result in the best credit experience, and that loans to pay for the purchase of clothes result in the worst experience. Loans in these two categories, however, account for very small proportions of the total number. For the classes containing the largest percentage of cases—the refinancing of bills and miscellaneous uses—credit experience appears to be about average.

TABLE 39

PERCENTAGE DISTRIBUTION OF GOOD-LOAN AND BAD-LOAN SAMPLES, BY INTENDED USE OF FUNDS[a]

Sample	Taxes	Vacation	Household	Help for Relative	Medical and Dental	Business	Clothing	Consolidation of Debts	Miscellaneous[b]	Total	Number of Loans
A Good	5.1	3.8	12 6	8 8	8 9	15 2	1 3	13 1	31 2	100 0	237
Bad	3 0	3.9	5 1	5 1	20 1	9.4	5 6	17 5	30.3	100 0	234
B Good	4 1	[c]	6.2	1 7	4 6	2 9	[c]	62 7	17.8	100 0	241
Bad	1 3	[c]	4 2	3 4	8 0	8 4	[c]	55 3	19 4	100 0	237
C Good	4.9	[c]	4.9	[c]	6 5	4 3	[c]	17.8	61 6	100 0	185
Bad	.5	[c]	5.3	[c]	8.0	8 0	[c]	31 9	46.3	100 0	188
ALL SAMPLES											
Good	4.7	1 8	8 2	4 1	6.6	7 7	9	32 4	33 6	100 0	663
Bad	1 7	1.4	4 9	3 6	12.3	8 6	2 7	35 2	29.6	100.0	659
Index of bad-loan experience	.36	78	.60	88	1 86	1.12	3.0	1 09	.88	1 00	
Index of distribution difference										11.2	

[a] See footnotes to Table 26, p. 125.
[b] Includes those not reporting on intended use of funds.
[c] Loans included in the "miscellaneous" group, because of the small number reporting; the classes were not consolidated, however, in computing the distribution of all samples or in computing the index of bad-loan experience.

7

Income, Expenses, Profits

As WAS shown in an earlier chapter, the functions performed by industrial banking companies have had a marked effect upon the financial structure of these institutions. In the record of their income, expenses and profitability, their functional character is reflected even more sharply.

INCOME

The income of industrial banking companies, like that of other consumer credit agencies, is derived mainly from interest and discounts on loans. Other sources of income are interest and dividends on securities, delinquency charges, insurance commissions, recoveries on loans previously charged off, profits on sales of securities, interest on bank deposits, rents and miscellaneous minor items. These sources vary in importance, of course, with the nature and diversity of operations of a given company; a firm engaged in what is in effect a general banking business will draw its income from a wide variety of sources, while a company which concentrates upon a straight consumer loan business will have a correspondingly less complicated income structure.

The relative significance of the different income sources is evidenced by several collections of data. Information collected by the North Carolina Banking Department, pertaining to industrial banking companies in that state, both Morris Plan and others, is presented in Table 40. These data cover a relatively small group of companies but they serve to indicate that interest and discounts on loans are of pre-

TABLE 40

PERCENTAGE DISTRIBUTION OF TOTAL INCOME OF NORTH CAROLINA INDUSTRIAL BANKING COMPANIES, 1928–38, BY SOURCE OF INCOME[a]

Year	*Number of Companies*	Source of Income: Interest and Discounts on Loans	Interest and Dividends on Securities	Other Current Operating Earnings	Recoveries on Loans and Profits on Assets Sold[b]	Total[c]	
1928	48	77.8	2	21 6	4	100 0%	$1,638
1929	45	85.2	.2	13.5	1.1	100 0	1,619
1930	41	82.7	3	15.3	1.7	100 0	1,644
1931	40	78 9	.3	19 5	1 3	100.0	1,697
1932	43	66 6	1 0	31 1	1 3	100 0	1,286
1933	33	70 4	2 0	24 8	2.8	100.0	800
1934	30	67.1	2 8	27.2	2.9	100.0	873
1935	29	63.9	3.7	28 1	4 3	100 0	1,020
1936	29	65 8	3 1	24.5	6 6	100 0	1,182
1937	32	67 0	2 8	26.0	4.2	100 0	1,348
1938	33	71.1	2.0	23 1	3.8	100.0	1,461

[a] Based on *Reports of the Condition of the State Banks*, State of North Carolina, Banking Department.
[b] Includes reductions in valuation allowances.
[c] Dollar figures in thousands.

dominant importance as a source of income. Year-to-year changes in the relative weight of this item during the period 1928-38 show no consistent trend, and it may be that the changes here revealed are traceable primarily to changes in the composition of the group of companies for which reports are available.

The significance of interest and discounts as a source of income is revealed also by Table 41, based on reports made to the Federal Deposit Insurance Corporation by insured

TABLE 41

PERCENTAGE DISTRIBUTION OF TOTAL INCOME OF INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY SIZE OF COMPANY AND SOURCE OF INCOME[a]

Year	*Size of Company*[b]	*Number of Companies*	*Source of Income*: Interest and Discounts on Loans	Interest and Dividends on Securities	Commissions, Fees, Collections, Exchanges, etc.	Other Current Operating Earnings	Recoveries on Loans[c]	All Other Recoveries[d]	Total[a]	
1934	All Companies	60	61 6	7.7	16.7	3.7	6.2	4.1	100.0%	$8,788
	Under $100	18	64.5	4.6	21 3	4.8	3.9	.9	100.0	436
	100– 200	22	66 8	6 2	19 0	3 8	2.5	1.7	100 0	1,214
	200– 300	8	66 7	1.7	10 2	13.9	5.5	2 0	100.0	598
	300– 500	5	67 4	2.1	17.5	6.4	3.3	3 3	100.0	783
	500– 1000	4	68 3	6.7	12.5	1 6	6.4	4.5	100 0	1,693
	1000 & over	3	55.1	10 8	18.0	2.5	8 2	5.4	100 0	4,064
1935	All Companies	62	64.1	6 0	17 0	3.3	6.3	3.3	100 0	10,233
	Under $100	18	64.5	8.3	17.6	3.6	4 0	2.0	100 0	505
	100– 200	22	64 9	6.1	19.7	2.2	2 1	5.0	100 0	1,576
	200– 300	10	65 3	1.9	16.4	8.0	6 8	1.6	100 0	795
	300– 500	5	72 5	1.4	14 1	6.3	4.0	1.7	100.0	845
	500– 1000	3	76 3	3.0	8 8	2.4	5 6	3.9	100 0	1,559
	1000 & over	4	58 4	8.1	19 3	2 6	8 3	3.3	100 0	4,953
1936	All Companies	63	66.4	4.2	15.2	3 0	7 5	3 7	100.0	12,264
	Under $100	17	70.3	3.2	17 9	1 9	2 2	4.5	100.0	464
	100– 200	20	66.6	5 6	17.2	.7	4 0	5.9	100.0	1,555
	200– 300	13	66 6	3.3	18 9	4 8	4 1	2 3	100 0	1,370
	300– 500	5	72 8	1 1	14 6	4.6	6.5	.4	100 0	786
	500– 1000	4	76 3	2 0	8.8	3 7	4.1	5.1	100 0	2,324
	1000 & over	4	61 2	5 5	16 2	2.7	11.2	3 2	100 0	5,765

TABLE 41

PERCENTAGE DISTRIBUTION OF TOTAL INCOME OF INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY SIZE OF COMPANY AND SOURCE OF INCOME[a] *(concluded)*

Year	*Size of Company*[b]	*Number of Companies*	Source of Income: Interest and Discounts on Loans	Interest and Dividends on Securities	Commissions, Fees, Collections, Exchanges, etc.	Other Current Operating Earnings	Recoveries on Loans[c]	All Other Recoveries[d]	Total[e]	
1937	All Companies	69	71.1	4.1	13.7	4.3	4.8	2.0	100.0%	$14,018
	Under $100	20	70.3	2.6	20.6	2.6	1.3	2.6	100.0	543
	100– 200	20	70.1	4.4	18.1	1.4	2.8	3.2	100.0	1,645
	200– 300	16	70.9	3.8	14.9	4.1	4.7	1.6	100.0	1,919
	300– 500	5	74.4	.8	14.0	5.3	4.5	1.0	100.0	848
	500– 1000	3	74.5	2.7	15.9	2.2	4.4	.3	100.0	1,465
	1000 & over	5	70.3	4.9	11.4	5.5	5.6	2.3	100.0	7,598
1938	All Companies	71	71.8	3.8	15.3	2.2	3.4	3.5	100.0	13,825
	Under $100	21	72.9	3.0	19.0	2.7	1.2	1.2	100.0	569
	100– 200	19	72.3	3.8	17.6	.9	3.8	1.6	100.0	1,604
	200– 300	17	71.9	1.6	17.7	2.1	2.6	4.1	100.0	2,069
	300– 500	7	71.1	3.9	13.0	7.1	2.7	2.2	100.0	1,112
	500– 1000	2	79.7	.6	15.7	1.0	1.4	1.6	100.0	508
	1000 & over	5	71.2	4.6	14.2	1.8	3.9	4.3	100.0	7,963

[a] Based on year-end data supplied by the Federal Deposit Insurance Corporation.
[b] As measured by total equity account (capital, surplus and undivided profits), in thousands of dollars. Each level is inclusive of the lower figure and exclusive of the higher.
[c] Includes reductions in valuation allowances on loans
[d] Includes reductions in valuation allowances on assets other than loans, and profits on assets sold or exchanged.
[e] Dollar figures in thousands.

industrial banking companies. From this table it appears that the size of the company, as measured by the total of capital, surplus and undivided profits, does not stand in any significant relationship to the percentage of income derived from interest and discounts on loans.

An important difference between industrial banking companies and commercial banks is brought out by a comparison of the income structures of the two types of institutions. Data published by the Federal Deposit Insurance Corporation indicate that for insured commercial banks interest and discounts on loans varied between 31.0 and 38.1 percent of total income over the period 1934-38.[1] Table 41, however, shows that for insured industrial banking companies this proportion was about twice as high during the same period. This divergence between the two types of institutions reflects differences in both asset structure and investment policy; as was noted in Chapter 3, industrial banking companies keep a much larger proportion of their total assets in loans and discounts than do commercial banks.

A final collection of data on sources of income is presented in Table 42, in regard to three separate groups of companies: Indiana industrial banking companies of the investment type; a mixed group of companies reporting to the American Industrial Bankers Association, and companies reporting to the Morris Plan Bankers Association. Again interest and discounts are seen to constitute the chief source of income, amounting in 1937 to approximately 75 percent of the total income of these companies.

The three tables here presented show also the relative unimportance, as a source of income, of interest and dividends on securities. In 1935, when the North Carolina industrial banking companies represented in Table 40 received a higher proportion of their total income from this source than in

[1] Federal Deposit Insurance Corporation, *Annual Report*, for the year ended December 31, 1938, Table 137, pp. 212-13.

TABLE 42

PERCENTAGE DISTRIBUTION OF TOTAL INCOME OF INDUSTRIAL BANKING COMPANIES REPORTING TO THE AMERICAN INDUSTRIAL BANKERS ASSOCIATION, 1936–37, TO THE MORRIS PLAN BANKERS ASSOCIATION, 1937, AND TO THE INDIANA BANKING DEPARTMENT, 1937, BY SOURCE OF INCOME

Source of Income	*Members of AIBA*[a]		*Members of Morris Plan Bankers Association*[b]	*Indiana Industrial Banking Companies*[c]
	1936	1937		
Interest and discounts on loans	74.7	73.3	75.6	78.7
Fees and charges	15.4	13.1	13.2	[d]
Delinquency charges	1.0	5.1	1.5	1.7
Insurance commissions	1.6	1.4	[d]	2.4
Interest and dividends on securities	0.2	0.8	[d]	3.3
Interest on bank balances	[d]	[d]	[d]	.1
Rent received	2.0[e]	0.9[e]	[d]	2.1
Recoveries on loans	4.1	3.2	[d]	3.7
Profits on assets sold or exchanged	[d]	[d]	[d]	.2
Other income	1.0	2.2	9.7	7.8
TOTAL[f]	100.0%	100.0%	100.0%	100.0%
	$2,201	$1,953	[g]	$ 603
Number of companies	47	37	[h]	8

[a]Based on data supplied by the American Industrial Bankers Association, covering both investment and non-investment types of institutions.
[b] Based on data supplied by the Morris Plan Bankers Association.
[c] Based on *Annual Report* of the Department of Financial Institutions of the State of Indiana, for the year ended June 30, 1938, p 89, data are for the calendar year 1937, and pertain to companies authorized to issue investment certificates.
[d] Not reported separately.
[e] Reported as real estate income.
[f] Dollar figures in thousands.
[g] Total income not given.
[h] Data are for all reporting Morris Plan banking companies; the number reporting is not given in the statement of the Morris Plan Bankers Association, but it represents a majority of the companies.

any other year, the figure was only 3.7 percent, as compared with 0.2 percent in the low years 1928-29. After 1935 this source of income for the North Carolina companies declined gradually until it stood at 2.0 percent in 1938. Table 42 shows a comparable low figure for Indiana industrial banking companies in 1937, and still lower ones for members of the American Industrial Bankers Association; Morris Plan companies do not report this income source separately. Table 41, covering insured companies—a group which generally holds a larger proportion of total assets in investment securities—corroborates the evidence in Table 40 that in recent years interest and dividends on securities have tended to decline in relative importance as a source of income. The proportion represented by this item fell from 7.7 in 1934 to 3.8 percent in 1938 for the entire group of companies; for the companies whose equity account was $1,000,000 or more the figure was well over average, and it tended to be lowest for the companies in the $200,000-1,000,000 groups.

In regard to income from securities the insured industrial banking companies stand in significant contrast to the insured commercial banks. For the latter, according to reports made to the Federal Deposit Insurance Corporation,[2] investment income varied between 26.7 and 30.4 percent of total income during these same years, and showed no consistent downward trend; it was lowest—26.7 percent—in 1936, and rose considerably in 1937, though it fell again in 1938. For commercial banks the income arising from security investments is nearly equal to the income from interest and discounts on loans, but for industrial banking companies this type of income is scarcely more than an incidental part of the earnings structure.

A group of related items may be considered together as a third source of income: recoveries on loans or other assets previously charged off; profits from the sale or exchange of

[2] *Ibid.*, p. 212.

assets; and reductions in valuation allowances. Table 41 indicates that for insured industrial banking companies this composite source provided, for the group as a whole, about one-tenth of total income in 1934-36, and about 7 percent in 1937-38. These items too are considerably less important for insured industrial banking companies than for insured commercial banks. For the latter their significance in total income varied between 16 and 27 percent during the years 1934-38, approximately three-fourths of this non-operating income originating in investment activity.[8] Year-to-year changes in the proportion of total income arising from recoveries on loans may indicate changes in economic conditions, reflected in a new development in collection experience, but also they may merely indicate changes in managerial policy, reflected in the relative volume of charge-offs and subsequent recoveries.

Chief among the other sources of industrial banking company income are various charges and fees, and insurance commissions. Income from property rented and interest on bank balances may also supply some incidental funds. The relative importance of these items may be gauged from Table 42, although these data should not be interpreted too literally, for companies are likely to follow different procedures in classifying such sources of income. It seems clear, however, that insurance commissions and delinquency charges are but minor sources of income for industrial banking companies.

On loans and discounts the ratio of earnings to total loan account, as contrasted to their ratio to total income, has tended to decline in recent years for those industrial banking companies whose deposits are insured by the Federal Deposit Insurance Corporation. In 1935 interest and discounts on loans, plus fees, commissions and charges, amounted for these companies to $9.38 per $100 of average loan account, but

[8] *Ibid.*, p. 212.

this figure had fallen to $8.73 by 1938.[4] During this same period commercial bank income from loans remained fairly stable, in relation to average loan account, ranging from $5.75 per $100 in 1935 to $5.91 in 1938.[5]

Also the average rate of income from security investments has tended to fall in recent years for insured industrial banking companies, declining from $4.07 per $100 of securities owned in 1935 to $3.24 in 1938.[6] This rate has fallen too for insured commercial banks—from $3.51 per $100 of securities owned in 1935 to $3.27 in 1938.[7]

EXPENSES

The main items of expense incurred by industrial banking companies are salaries and wages, interest paid on deposits and outstanding investment certificates, interest and discounts on borrowed money, losses resulting from the charging off of defaulted loans and from the sale of assets, and taxes.

Table 43, pertaining to the same group of North Carolina industrial banking companies, shows that salaries, wages and fees constituted (except in 1932) the greatest single item of expense during the years 1928-38, ranging from one-fifth to two-fifths of total expenses over this period; the proportion represented by this item decreased in the years 1928-32, and thereafter rose to a figure considerably beyond its 1928 level. Also for the group of insured industrial banking companies the proportion of expenses accounted for by salaries, wages and fees has increased in recent years; as can be seen from

[4] Computed from data provided by the Federal Deposit Insurance Corporation.

[5] Federal Deposit Insurance Corporation, *Annual Report*, for the year ended December 31, 1938, p 57.

[6] Computed from data provided by the Federal Deposit Insurance Corporation.

[7] Federal Deposit Insurance Corporation, *Annual Report*, for the year ended December 31, 1938, p. 57.

TABLE 43

PERCENTAGE DISTRIBUTION OF TOTAL EXPENSES OF NORTH CAROLINA INDUSTRIAL BANKING COMPANIES, 1928–38, BY TYPE OF EXPENSE[a]

Type of Expense	*1928*	*1929*	*1930*	*1931*	*1932*	*1933*	*1934*	*1935*	*1936*	*1937*	*1938*
Interest on time and savings deposits	21.3	20.4	23.2	21.9	21.2	18.2	11.7	17.0	18.3	16.9	16.8
Interest and discounts on borrowed money	9.1	9.7	5.8	4.9	4.6	3.0	1.8	1.4	.9	1.9	1.1
Salaries, wages and fees	29.6	29.0	27.8	26.0	19.7	28.1	27.9	31.5	39.5	38.7	39.1
Taxes (other than income)	12.4	12.4	10.6	8.0	9.0	10.2	10.0	13.6	9.5	9.4	9.2
Other current operating expenses	23.4	23.8	23.9	21.1	25.0	23.2	21.2	25.3	23.5	26.4	23.6
Charge-offs and losses on assets sold[b]	4.2	4.7	8.7	18.1	20.5	17.3	27.4	11.2	8.3	6.7	10.2
TOTAL[c]	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
	$1,092	$1,186	$1,336	$1,589	$1,136	$753	$796	$748	$744	$863	$958
Number of companies	48	45	41	40	43	33	30	29	29	32	33

[a] Based on *Reports of the Condition of the State Banks*, State of North Carolina, Banking Department.
[b] Not reported separately.
[c] Dollar figures in thousands.

TABLE 44

PERCENTAGE DISTRIBUTION OF TOTAL EXPENSES OF INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY SIZE OF COMPANY AND TYPE OF EXPENSE[a]

			Type of Expense								
Year	*Size of Company*[b]	*Number of Companies*	Interest on Time and Savings Deposits	Interest and Discounts on Borrowed Money	Salaries, Wages and Fees	Taxes (including income taxes)	Other Current Operating Expenses	Losses on Loans	All Other Losses	Total[c]	
1934	All Companies	60	19.9	1.0	27.8	2.6	25.0	15.4	8.3	100.0%	$8,411
	Under $ 100	18	17.9	.6	27.9	7.8	22.8	16.9	6.1	100.0	408
	100– 200	22	16.2	.6	28.6	4.2	27.9	18.8	3.7	100.0	1,157
	200– 300	8	13.2	4.2	28.2	7.2	26.6	20.0	.6	100.0	500
	300– 500	5	16.2	.8	34.1	4.3	30.8	8.2	5.6	100.0	654
	500– 1000	4	14.8	3.4	32.7	3.2	28.1	13.2	4.6	100.0	1,497
	1000 & over	3	24.2	.0	24.9	.7	22.2	15.6	12.4	100.0	4,195
1935	All Companies	62	19.1	.8	29.9	3.6	26.8	12.5	7.3	100.0	8,875
	Under $ 100	18	19.2	.3	30.4	9.5	21.4	16.0	3.2	100.0	401
	100– 200	22	17.2	.4	29.2	6.1	28.2	12.5	6.1	100.0	1,315
	200– 300	10	14.4	1.4	31.3	7.5	29.0	14.8	1.6	100.0	627
	300– 500	5	17.4	.3	37.6	5.0	29.9	7.0	2.8	100.0	685
	500– 1000	3	17.3	3.8	33.4	2.7	32.0	9.5	1.3	100.0	1,338
	1000 & over	4	21.0	.0	27.6	1.9	24.6	13.5	11.4	100.0	4,509
1936	All Companies	63	18.9	.7	31.3	2.7	26.0	10.3	10.1	100.0	9,688
	Under $ 100	17	18.8	.3	34.9	7.0	24.3	8.2	6.5	100.0	341
	100– 200	20	18.4	.4	31.5	4.5	25.5	11.6	8.1	100.0	1,144
	200– 300	13	17.5	.8	30.8	5.5	28.0	9.0	8.4	100.0	1,096
	300– 500	5	17.4	1.2	39.0	2.6	27.1	8.6	4.1	100.0	580
	500– 1000	4	17.1	2.4	35.8	1.1	29.2	9.1	5.3	100.0	1,892
	1000 & over	4	20.3	.0	28.5	2.0	24.3	11.1	13.8	100.0	4,745

TABLE 44

PERCENTAGE DISTRIBUTION OF TOTAL EXPENSES OF INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY SIZE OF COMPANY AND TYPE OF EXPENSE[a] (*concluded*)

Year	*Size of Company*[b]	*Number of Companies*	Type of Expense: Interest on Time and Savings Deposits	Interest and Discounts on Borrowed Money	Salaries, Wages and Fees	Taxes (including income taxes)	Other Current Operating Expenses	Losses on Loans	All Other Losses	Total[c]	
1937	All Companies	69	19 7	.4	32.2	3.2	26.4	8.0	10.1	100 0%	$11,102
	Under $ 100	20	18.9	.3	36.9	6 3	26 5	4 5	6.6	100 0	396
	100– 200	20	18.1	.9	32.8	5 0	25.2	8 1	9.9	100 0	1,169
	200– 300	16	18.6	.9	31 3	5 1	27.8	10.2	6 1	100 0	1,477
	300– 500	5	17.8	1.6	38 6	3.0	28 3	8.8	1.9	100 0	634
	500– 1000	3	16 4	.8	33.5	1.7	31 4	7 4	8.8	100 0	1,294
	1000 & over	5	21.2	.2	31 1	2 5	24 9	7.7	12.4	100.0	6,132
1938	All Companies	71	19.3	.3	34.4	3 5	26.3	8 2	8 2	100.0	10,588
	Under $ 100	21	19.0	.2	38.3	8.2	23 7	6.0	6.0	100 0	415
	100– 200	19	16.6	.3	31.1	4.6	21 6	9.8	9.8	100.0	1,315
	200– 300	17	17.1	.2	31.7	4 7	29.2	12.9	12.9	100 0	1,607
	300– 500	7	18.9	.8	36.3	3.3	29.7	7 3	7.3	100 0	909
	500– 1000	2	12.8	2.3	40.7	2 3	33.1	6 5	6 5	100 0	384
	1000 & over	5	21.0	.1	35.0	2 6	25 9	6.9	6.9	100 0	5,958

[a] Based on year-end data supplied by the Federal Deposit Insurance Corporation.
[b] As measured by total equity account (capital, surplus and undivided profits), in thousands of dollars. Each level is inclusive of the lower figure and exclusive of the higher.
[c] Dollar figures in thousands.

Table 44, it rose steadily from nearly 28 percent in 1934 to nearly 35 percent in 1938. Except in 1938, when they were about average, the companies whose equity account was $1,000,000 or more had the lowest proportion of expense

TABLE 45

PERCENTAGE DISTRIBUTION OF TOTAL EXPENSES OF INDUSTRIAL BANKING COMPANIES REPORTING TO THE MORRIS PLAN BANKERS ASSOCIATION AND TO THE INDIANA BANKING DEPARTMENT, 1937, BY TYPE OF EXPENSE

Type of Expense	*Members of Morris Plan Bankers Association*[a]	*Indiana Industrial Banking Companies*[b]
Salaries and wages	31.1	31.9
Director and loan committee fees	[c]	1.8
Interest on investment certificates	22 2	21.3
Interest on borrowed money		2 5
Rent	5.0	4 3
Advertising	5.9	6.8
Auditing	[c]	.6
Taxes	7.8[d]	8 7
Losses on loans	9 2	9.4
Losses on securities sold		.1
Credit information	[c]	.8
Other expenses	18.8	11.8
TOTAL[e]	100 0%	100 0%
	[f]	$ 452
Number of companies	[g]	8

[a] Based on data supplied by the Morris Plan Bankers Association.
[b] Based on *Annual Report* of the Department of Financial Institutions of the State of Indiana, for the year ended June 30, 1938, p 89; data are for the calendar year 1937, and pertain to companies authorized to issue investment certificates.
[c] Not reported separately.
[d] Includes payments for licenses.
[e] Dollar figure in thousands.
[f] Total expenses not given.
[g] Data are for all reporting Morris Plan banking companies; the number reporting is not given in the statement of the Morris Plan Bankers Association, but it represents a majority of the companies.

for this item, and the $300,000-500,000 companies had the highest (again with the exception of 1938). These various findings as to the relative importance of salary expense are corroborated in Table 45 for Morris Plan companies and for industrial banking companies in Indiana.

As for the firms reporting to the American Industrial Bankers Association, the data presented in Table 46 show that the proportion of expenses accounted for by salaries and wages does not differ significantly between the investment and the non-investment institutions. In 1936 and 1937 the figures reported by the AIBA members were very nearly the same as those shown for the same years for the other groups of companies discussed (with the single exception of the North Carolina companies, for which salaries represented a relatively larger item).

The next most important expense item for industrial banking companies is the cost of borrowing money from banks or of obtaining funds from depositors or purchasers of investment certificates. Table 43 shows that for the North Carolina companies the two items, interest paid on deposits and interest paid on borrowings, varied widely in relation to total expenses over the eleven-year period. The former item tended to decline in relative importance from 1928 to 1934, increased from 12 to 17 percent in 1935 and thereafter remained fairly constant; interest on borrowings decreased fairly steadily throughout the period, from 9 to 1 percent. This item represented a much smaller proportion for the group of insured companies, but for them too it declined in the period 1934-38—from 1 to 0.3 percent, as shown in Table 44; for these companies interest on time and savings deposits remained fairly steady, at about one-fifth of total expenses. Size of institution seems to bear no significant relation to the relative importance of these expenses, except for the fact that in each of the years 1934-38 the companies of $1,000,000 or more in equity account reported the highest

TABLE 46

PERCENTAGE DISTRIBUTION OF TOTAL EXPENSES OF REPORTING MEMBERS OF AMERICAN INDUSTRIAL BANKERS ASSOCIATION, 1936–37, BY TYPE OF EXPENSE[a]

Type of Expense	1936 Investment Companies[b]	1936 Non-Investment Companies	1936 All Companies	1937 All Companies
Salaries	29 0	32 6	30.0	33 8
Rent	3.4	5.9	4 1	3.9
Advertising	3.7	2 9	3 5	3.7
Interest on deposits, investment certificates and bank loans	20 2	7 2[c]	16.4	18 3
Interest on bonds and payments on preferred stock	.9	2.9	1.5	3.3[d]
Charge-offs and provisions for losses	14 4	15 2	14 7	10 8
Insurance and bond premiums	1.6	1 8	1 6	1.8
Provisions for taxes	7 8	10.8	8 7	8.4
Other expenses	19 0	20.7	19 5	16.0
TOTAL[e]	100.0%	100 0%	100.0%	100.0%
	$1,010	$420	$1,430	$1,190
Number of companies	25	21	46	34

[a] Based on year-end data supplied by the American Industrial Bankers Association.
[b] Investment companies are those companies that accept deposits or sell certificates.
[c] Represents interest on bank loans only.
[d] Represents payments on preferred stock only.
[e] Dollar figures in thousands

percentage of total expense for interest on time and savings deposits.

As was pointed out in Chapter 3, the acceptance of deposits and the sale of investment certificates constitute a major source of working funds for firms which can be classified as

industrial banking companies under the definition used in this volume. The value of this criterion is demonstrated in Table 46, in which companies reporting to the American Industrial Bankers Association are divided, for the year 1936, into two groups, investment and non-investment. The non-investment companies, of course, had no expenses for funds obtained from deposits and investment certificates. For payments on bank borrowings, however, and on bonds and preferred stock, they had a higher proportion of expense than did the group of investment companies.

All industrial banking companies incur some expense on charged-off loans, and although in any one year charge-offs, net of recoveries, may amount to as little as 1 percent, or even less, of the loans made during that year, it is not to be inferred that such losses are of negligible significance. Nor can the importance of such losses be measured solely by a computation of their relation to total expenses over a given period of time; a considerable proportion of wages and other expenses should be included in any calculation of the total cost of collecting industrial loans, and this procedure would involve a highly arbitrary scheme of cost allocation. It is not possible, therefore, to do more than show the relative importance of the loss expense item alone, as compared with other types of expense.

Table 43 indicates that for North Carolina firms charge-offs and losses from the sale of assets amounted, together, to widely varying proportions of total expenses, ranging from 4 to 27 percent over the period 1928-38; they were relatively most important in the years 1931-34. Industrial banking firms insured by the Federal Deposit Insurance Corporation submit reports from which losses on loans may be computed separately from other losses. The data in Table 44 show that for all insured companies losses on loans fell from 15 percent of total expenses in 1934 to 8 percent in 1937-38; losses on securities showed less variation, ranging from 7 to

10 percent with no discernible trend. Losses incurred through the sale of securities were far less for the group of Indiana industrial banking companies covered in Table 45, amounting to only 0.1 percent of total expenses in 1937; these companies' losses on loans were about 9 percent in that year, and the loss percentage on loans and securities combined was practically the same as that of the Morris Plan companies reporting for 1937. For the members of the American Industrial Bankers Association, represented in Table 46, the figure on combined losses in 1937 was not greatly different—around 11 percent—and the data for 1936 show little variation between the investment and the non-investment institutions in this respect.

The relative importance of taxes as an item of expense is also to be gauged from the tables already presented. Although the data on tax expenditures for North Carolina companies, as given in Table 43, do not include the corporation income tax paid by these firms, the tax item nevertheless amounted to approximately 10 percent of total expenses in the period 1928-38, ranging between 8 percent in 1931 and nearly 14 percent in 1935. Expenditures for taxes, including income taxes, by insured industrial banking companies were much lower, as Table 44 indicates; in the years 1934-38 they fluctuated narrowly around 3 percent of total expenses. Comparable data in Tables 45 and 46 are in rough conformity with those for the North Carolina companies; here too taxes, including corporation income taxes, accounted for about 10 percent, or less, of total expenses.

It was pointed out above that in the years 1935-38 insured industrial banking companies experienced a decrease in their average loan income per $100 of loan account. But their current operating expenses (exclusive of charge-offs, losses on assets sold or exchanged and increases in valuation allowances) also declined during this period, falling from

$7.14 per $100 of average loan account in 1935 to $6.42 per $100 of average loan account in 1938.[8]

PROFITS

The profit record of industrial banking companies over a period of years reveals that despite depression lows these institutions have shown a remarkable earning capacity. Table 47 shows that in the period 1922-38 the net earnings of Morris Plan banking companies averaged about 10 percent of total equity account. From an average of nearly 12 percent in the years 1922-29 they fell to 3 percent in 1933, but thereafter recovered fairly rapidly, and by 1937 had reached nearly 14 percent, a level never before attained by Morris Plan institutions. It is true, however, that these data pertain to a changing group of companies, and are thus subject to some criticism. Therefore it is worth noting that figures on 86 identical Morris Plan companies corroborate the evidence presented here that net earnings have in recent years represented a higher proportion of equity funds than they did before the depression; for the 86 companies this figure was 13 percent in 1938, as compared with 11.5 percent in 1929.[9]

Table 48, based on reports to the Federal Deposit Insurance Corporation by insured industrial banking companies, shows, for 1934-38, net profits after income taxes and net profits after the total of income taxes, dividends and interest on capital. Of the two sets of figures the former are the closer to those in Table 47, but they are not strictly comparable because they are not exclusive of interest on capital notes and debentures. It is not likely, however, that these profit percentages would be much lower if they excluded this item; as was indicated in Chapter 3, these insured com-

[8] Computed from data provided by the Federal Deposit Insurance Corporation.
[9] Industrial Finance Corporation, *Annual Report to Stockholders*, for the year ended January 31, 1939, p. 5.

TABLE 47

Net Profits of Reporting Morris Plan Banking Companies, 1922–38, in Dollars and in Percent of Total Equity Account[a]

Year	*Number of Companies*	*Net Profits*[b]	
1922	[c]	$1,506,004	9.0%
1923	[c]	1,925,192	10.8
1924	100	2,472,154	12.8
1925	106	2,842,317	13.3
1926	106	3,003,419	12.8
1927	106	3,029,129	12.0
1928	108	3,152,490	11.4
1929	108	3,129,773	11.2
1930	108	2,604,511	8.5
1931	106	1,957,525	6.7
1932	102	1,046,049	4.0
1933	92	696,187	3.0
1934	92	1,412,847	6.2
1935	92	2,357,201	9.8
1936	89	2,861,569	11.8
1937	86	3,480,097	13.6
1938	86	3,581,858	13.0

[a] Based on data from Industrial Finance Corporation annual reports to stockholders. With the exception of 1938, the data for each year are from the annual report for the year ended January 31, two years later; data for 1938 are from the report for the year ended January 31, 1939.

[b] Net profits after income taxes and interest paid on capital notes and debentures. For the percentage figures the base, total equity account, comprises paid-in capital, surplus and undivided profits. For 1934-38 these data are as of the end of the year; for all other years surplus and undivided profits are as of the end of the year and capital is an average of figures for the beginning and for the end of the year.

[c] Number of companies not given.

panies obtained but a negligible proportion of their funds from borrowings—never as much as 2 percent and in 1938 only 0.1 percent of total assets.[10] It is not possible to determine the extent to which these profit percentages would be

[10] Table 2, p. 60.

TABLE 48

Net Profits of Insured Industrial Banking Companies, in Dollars and in Percent of Total Equity Account, 1934–38, by Size of Company[a]

Year	Size of Company[b]	Number of Companies	Net Profits After Taxes[c]		Dividends and Interest[d]	Net Profits After Taxes, Dividends and Interest[e]	
1934	All Companies	60	$ 377	2.4%	$ 415	$ − 38	− .2%
	Under $ 100	18	28	2.3	36	− 8	− .7
	100– 200	22	57	1.8	54	3	.1
	200– 300	8	98	5.7	52	46	2.7
	300– 500	5	129	7.0	67	62	3.4
	500– 1000	4	196	7.1	171	25	.9
	1000 & over	3	−131	−2.6	35	−166	−3.3
1935	All Companies	62	1,358	7.1	627	731	3.8
	Under $ 100	18	104	8.4	64	40	3.2
	100– 200	22	261	7.7	102	159	4.7
	200– 300	10	168	6.9	66	102	4.2
	300– 500	5	160	8.4	83	77	4.0
	500– 1000	3	221	10.8	93	128	6.2
	1000 & over	4	444	5.5	219	225	2.8
1936	All Companies	63	2,180	11.2	811	1,369	7 0
	Under $ 100	17	107	9.2	45	62	5.3
	100– 200	20	363	11.9	115	248	8 2
	200– 300	13	238	8.0	112	126	4.2
	300– 500	5	175	9.7	71	104	5.8
	500– 1000	4	371	13 9	137	234	8.8
	1000 & over	4	926	11.9	331	595	7.6
1937	All Companies	69	2,402	11.3	932	1,470	6.9
	Under $ 100	20	121	9.1	51	70	5.2
	100– 200	20	410	13.5	111	299	9.8
	200– 300	16	374	10.1	147	227	6.1
	300– 500	5	173	9.1	77	96	5.0
	500– 1000	3	141	7.1	75	66	3.3
	1000 & over	5	1,183	12 8	471	712	9.1
1938	All Companies	71	2,638	13.0	1,091	1,547	7 6
	Under $ 100	21	124	8.3	51	73	4 9
	100– 200	19	209	6.5	140	69	2 2
	200– 300	17	385	9.6	168	217	5 4
	300– 500	7	157	6.2	85	72	2 8
	500– 1000	2	99	7.8	77	22	1 8
	1000 & over	5	1,664	21.1	570	1,094	13 9

[a] Based on year-end data supplied by the Federal Deposit Insurance Corporation.

[b] As measured by total equity account (capital, surplus and undivided profits), in thousands of dollars Each level is inclusive of the lower figure and exclusive of the higher

[c] Net profits after income taxes, in thousands of dollars and in percent of total equity account at beginning of year.

[d] Dividends paid on preferred and common stock and interest paid on capital notes and debentures, in thousands of dollars

[e] Net profits after income taxes, dividends and interest on capital notes and debentures, in thousands of dollars and in percent of total equity account at beginning of year.

reduced if they were expressed in the same way as those in Table 47, but even without such adjustment they reveal that the insured companies, as a group, had a less favorable earnings record during the years 1934-38 than did the entire group of reporting Morris Plan companies.

When the insured companies' profit ratios are examined with reference to the size of the institution, it appears that the largest companies, those with a total equity account of $1,000,000 or over, had the greatest variation in earnings during 1934-38. In 1934 these companies showed a loss in their percentage for net profits after income taxes, the only loss recorded for this item by any group of companies during the entire five-year period; in 1938, however, these companies' net earnings after income taxes amounted to 21 percent of total equity account, the highest proportion found for any size class. Neither set of net profit percentages reveals any close relation between size of company and earning capacity. This lack of correlation is borne out by earnings data, not presented here, for North Carolina industrial banking companies. In 1934 and 1935 firms in that state were classified into three size classes, and in 1934 the largest companies were found to have the lowest ratio of net profit (after income taxes and preferred stock dividends) to total equity account, while in 1935 they had the highest.

The high earnings record of industrial banking companies is further illustrated in Table 49, which compares, for insured industrial banking companies and commercial banks, net profits after payment of income taxes, and after payment of income taxes, dividends and interest on capital, per $100 of total assets. For both items the industrial banking companies are shown to have had higher rates, in all five years of the period 1934-38. The explanation is to be found, of course, in the differences in the asset distributions of the two types of institutions. Industrial banking company assets, as has previously been noted, are almost exclusively short-term

TABLE 49

SELECTED EXPENSE, EARNINGS AND PROFIT ITEMS, PER $100 OF TOTAL ASSETS, FOR INSURED INDUSTRIAL BANKING COMPANIES AND INSURED COMMERCIAL BANKS, 1934–38[a]

Item	1934		1935		1936		1937		1938	
	Industrial Bank. Cos.	Commercial Banks	Industrial Bank. Cos.	Commercial Banks	Industrial Bank. Cos.	Commercial Banks	Industrial Bank. Cos	Commercial Banks	Industrial Bank. Cos.	Commercial Banks
Total current operating expenses	$6.25	$2.48	$5 77	$2 24	$5 34	$2.09	$5 19	$2 11	$5 23	$2 09
Net current operating earnings	1.42	1 00	1 73	92	2 11	.83	2.27	.86	2 36	.78
Net profits after income taxes	.37	– 75	1 10	.43	1 49	.98	1.37	.69	1 58	54
Net profits after taxes, dividends and interest[b]	– 04	–1.17	59	..	.94	.56	.84	.28	91	.14
Number of institutions	60	14,124	62	14,110	63	13,956	69	13,783	71	13,645

[a] For industrial banking companies based on data supplied by the Federal Deposit Insurance Corporation. For commercial banks based on Federal Deposit Insurance Corporation, *Annual Report*, for the year ended December 31, 1938, Table 137, pp. 212-13 Total assets of industrial banking companies are as of the end of the year; those of commercial banks are averages of assets at beginning, middle and end of year

[b] After income taxes, dividends paid on preferred and common stock and interest paid on capital notes and debentures.

consumer loans. Commercial bank assets, on the other hand, are about evenly divided among cash, investment securities (public and private) and loans and discounts. Moreover, only a relatively small part of the loans and discounts of commercial banks would carry rates of interest as high as those required by industrial banking companies. It is because of their relatively high rate of net current operating earnings that industrial banking companies are able to show higher profit ratios than commercial banks, for the latter spend considerably less per $100 of total assets than the former on current operating expenses.

8

Competitive and Cooperative Relations

SINCE industrial banking companies engage in many forms of lending which closely approximate and at times conflict with the activities of other types of consumer credit agencies, they must compete not only with firms in their own field but also with personal finance companies, credit unions, sales finance companies, and the personal loan and time-sales departments of commercial banks. Seeking to clarify their own competitive situation, and also to resolve a number of other problems peculiar to their operations, most of the industrial banking firms have joined together in cooperative associations. The present chapter discusses the nature of competition in industrial lending, and also describes the aims and functions of the cooperative associations that have been formed by organizations operating in this field.

COMPETITION BETWEEN INDUSTRIAL BANKING COMPANIES AND OTHER AGENCIES

The intensity of the competition to which industrial banking companies are subject is to be attributed to their somewhat anomalous position in the field of consumer instalment financing. When they extend cash loans they compete not only with personal finance or small loan companies and credit unions,[1] but also with commercial banks. When they

[1] Since the activities of credit unions have not been included in the Studies in Consumer Instalment Financing, undertaken by the National Bureau of Economic Research, they are not considered in this discussion of competition.

finance instalment purchases they must meet competition from sales finance companies and again from commercial banks. Furthermore, the companies which account for the bulk of industrial loan credit compete with commercial banks for commercial loans and for deposits. Some firms, of course, confine their activities to the granting of small consumer loans, and their competitive situation is correspondingly simplified.

In a number of localities industrial banking companies are engaged, too, in active competition with one another. It has been the policy of the Morris Plan system to enfranchise only one company in a city, but the recent growth of companies not affiliated with this system has introduced a new element of rivalry into the competitive picture.

Competition between industrial banking companies and small loan companies is significantly influenced by the legal conditions under which these two types of agencies operate. The loans made by the latter are limited, in most states, to $300 or less, while for the former the amount of credit that may be extended in a single transaction is seldom so severely restricted. Sometimes, however, industrial banking companies too operate under small loan laws, in which case their loans are likewise kept to a $300 maximum, and in the District of Columbia all companies, except those operating on bank charters, are forbidden to extend cash loans in excess of $200.[2]

The average size of note for small loan companies varies somewhat between states and for different chain companies, but it does not exceed $200 and is generally closer to $150.[3] On the other hand, the average size of note for Morris Plan banks and companies, when all types of loans are considered,

[2] See Chapter 2, pp. 37-39.

[3] National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (1940) Table 7, p. 47.

ranges mainly between $250 and $300.[4] This difference is accounted for in part by the fact that the industrial banking companies deal in certain types of loans, such as sales financing and real estate credit, which small loan companies are not permitted to extend. As for comaker loans made by industrial banking companies, they are in some cases of approximately the same size as those granted by small loan companies[5] and in other cases somewhat larger.[6] The variation in the size of such loans indicates that some industrial banking companies are in closer competition with personal finance companies than others.

The intensification of competition between industrial banking and personal finance companies has arisen from the fact that the former have departed from their almost exclusive preoccupation with comaker loans. Thus the advantage of the personal finance company, which could at one time advertise the uniquely confidential character of its lending operations, has been substantially diminished in recent years by the increasing tendency of industrial banking companies to extend loans secured by the maker's name alone, or by the signatures of husband and wife, or even by household chattels. The last type of loan stands, of course, in direct competition with the primary business of personal finance companies.

From the data at hand it is impossible to measure statistically the income distribution of borrowers from industrial banking companies. The scattered evidence available does suggest, however, that the larger companies depend much less heavily than do personal finance companies on borrowers with annual incomes of $1200 and less, while, in general, the smaller companies cater to borrowers whose income distribution is similar to that of customers of chain

[4] See Table 14, p. 85.
[5] See Table 15, p. 86.
[6] See Table 16, p. 87.

small loan companies.[7] It is probably because in most states they have been granted greater latitude than small loan companies in the matter of maximum size of loan, that industrial banking companies have tended on the whole to attract borrowers in higher income groups.

Data on the occupational distribution of customers of chain personal finance companies show that approximately 50 percent of such borrowers are drawn from the wage-earning classes, about 25 percent from clerical and commercial groups, and about 5 percent from the professional class. Although no comparable data on the occupational distribution of industrial banking company borrowers can be obtained at present, it appears from the limited information available that these companies draw a smaller proportion of their borrowers from wage-earners and larger proportions from the clerical and professional classes than do the chain personal finance companies.[8]

As a general rule small loan companies quote charges as a monthly rate of interest on unpaid principal balance, this rate representing the entire cost of the loan to the borrower. Industrial banking companies, however, almost always quote charges on cash loans as a rate of discount, and in addition levy a fee for credit investigation. Because of this difference in methods of rate quotation the consumer is likely to be confused as to the relationship between the charges of the two types of agencies, and their competitive relations are undoubtedly affected by this situation.

The charges of industrial banking companies, when expressed as an annual effective rate on regularly declining credit balance, amount roughly to twice the rate of discount. When expressed in this way the combined maximum discount and credit investigation charge permitted by special statutes governing industrial banking companies amounts to

[7] See Table 33, p. 136; also Ralph A. Young and Associates, *op cit*, pp 51-54
[8] See Table 30, p. 131; also Ralph A Young and Associates, *op. cit*, pp. 56-60.

approximately 16 to 20 percent.[9] This is lower than the rates charged by small loan companies, which range commonly from 30 to 42 percent when expressed as an annual equivalent of the quoted monthly rate of interest.[10] In many instances competition has operated to reduce the actual rates charged by industrial banking companies to levels lower than the legal maxima. This is most likely to occur where competition with the personal loan departments of commercial banks is especially strong.

Industrial banking companies, as has already been noted, have branched out also toward the development of a larger volume of sales finance business. Through this type of financing the industrial banking company comes into direct competitive contact with sales finance companies and with the time-sales departments of commercial banks. Competition is keenest in the field of automobile financing, for here local, regional and national sales finance companies are actively engaged in serving the same markets as those sought by some industrial banking companies and commercial banks.

The character of competition in this field is conditioned in part by the fact that in most cases the industrial banking companies conduct their sales financing as independent units, whereas in 1937 approximately 75 percent of the automobile instalment financing handled by sales finance companies was conducted by three national chains.[11] The independent position of some Morris Plan banks and companies is modified to a limited degree by the fact that they operate either as wholly owned or as partially owned subsidiaries of companies controlled by the Industrial Finance Corporation. These corporate relationships, however, are not such as to affect the

[9] See Chapter 2, pp. 39-41.

[10] Ralph A. Young and Associates, *op. cit.*, pp 125-28

[11] National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices*, by W. C. Plummer and R. A. Young (1940) Table 67, p. 264; the three national companies are there designated as "factory-related"

competitive position of the individual Morris Plan banks and companies. In a few cases industrial banking companies, both Morris Plan and others, operate branches or exercise control over other banking companies through stockownership. In such cases it is possible to coordinate the activities of a number of units into a regional system and thus to take advantage of certain operating efficiencies inherent in this form of organization.

In the past a part of the sales financing activities of some Morris Plan banks and companies was carried out through the Industrial Acceptance Corporation. As pointed out above,[12] those companies in which the Industrial Finance Corporation had a controlling stock interest financed time sales of General Electric products through local subsidiaries, and rediscounted their receivables when necessary with the Industrial Acceptance Corporation. All other time-sales financing was handled directly by the local Morris Plan banks and companies.

The Industrial Acceptance Corporation also entered into an agreement with the Studebaker Corporation whereby it financed instalment sales of the cars produced by that manufacturer. Subsidies were paid to the Industrial Acceptance Corporation by the Studebaker Corporation on a plan not unlike the arrangements formerly in effect between other sales finance companies and certain automobile manufacturers.[13] In its automobile financing the Industrial Acceptance Corporation passed credits and made all collections on its consumer notes. Local Morris Plan banks and companies were not concerned in this financing arrangement.

In competing for retail sales finance business industrial banking companies are confronted by the same problems that beset any consumer credit agency operating in this field.

[12] Chapter 1, p. 21.

[13] See Chapter 1, p. 21; also W. C. Plummer and R. A Young, *op cit.*, pp. 266-67.

Where they propose to obtain a substantial volume through dealer contacts, competition requires that they provide the dealer with a reserve sufficient to hold his business, if contracts are purchased on a recourse or repurchase arrangement, or that they offer some kind of bonus, if transactions are effected on a non-recourse basis. In automobile financing, the financing agency is likely to be called upon also to extend credits to dealers to enable them to carry inventories. Credit demands of this sort are likely to be large, especially in transactions with dealers who are in a position to create a large volume of retail instalment paper, and such demands cannot be met easily by the relatively small firms which constitute the majority of industrial banking companies.

As an alternative to obtaining retail instalment business through dealer contacts, some companies have adopted the policy of direct solicitation of purchasers. When this procedure is followed the industrial banking company can select its risks with somewhat greater care than it could otherwise, but it is at the same time cut off from dealers who might provide a ready supply of retail contracts.

Although industrial banking companies have increased their volume of sales financing in recent years they still occupy a relatively insignificant position in the field, far behind that of sales finance companies. It has been estimated that a total of $4,279,000,000 of retail instalment credit was extended in 1937,[14] and of this amount Morris Plan banks and companies, according to data from the Industrial Finance Corporation and The Morris Plan Corporation of America, accounted for only about 1 percent, whereas sales finance companies accounted for about 51 percent.[15] On the other hand, only about one-fifth of the credit extended by Morris Plan companies was for the financing of retail sales. Data on the sales financing activities of other industrial bank-

[14] W. C. Plummer and R. A. Young, *op. cit.*, p. 41.
[15] *Ibid.*, p. 43.

ing companies, outside the Morris Plan system, are not available, but it is unlikely that such figures would more than double the estimate of about 1 percent participation.

Evidence is not available to show how the price policy of industrial banking companies compares with that followed by the three largest sales finance companies. Since only a very small share of the sales finance market is reached by industrial banking companies, it is unlikely that such firms exert a strong influence on competitive conditions in the country as a whole, although in particular communities their operations may attain considerable importance.

Industrial banking companies are in competition with sales finance companies also in the cash loan field, although this development is as yet relatively unimportant. In some instances sales finance companies have licensed their offices as small loan companies in order that they may make renewals on contracts that originated with the instalment sale of a commodity. This enables the sales finance company also to make cash loans to individuals not indebted to them on a retail instalment sales contract. One national sales finance company has recently qualified most of its Pennsylvania offices under the Consumer Discount Act of that state. By this action the company enables itself to compete directly with industrial banking companies in making cash loans up to $5000 in size.

The commercial bank is a more recent rival of the industrial banking company than either the small loan or the sales finance company, yet it is considered by many industrial lenders to be the most important of all competitors. A comparison of the small-loan customers served by industrial banking companies and by commercial banks reveals certain broad similarities. In a sample of 1,260 personal loans made by commercial banks 12 percent of the borrowers had incomes of $1200 or less, and in a much smaller sample of

loans made by industrial banking companies 16 percent of the borrowers were in this income group.[16] Thus both samples indicate a predominant reliance on the higher income classes of borrowers, though these comparisons must be regarded as very rough measures, since the sample of industrial banking company loans is extremely small and therefore subject to considerable sampling error. A comparison of these loan samples according to amount of note shows that the two types of agencies make loans of approximately the same size, each writing about 50 percent of its notes in amounts of less than $200.[17]

Equally fragmentary are the data for comparing the occupational groups served by industrial banking companies and by commercial banks, in their personal lending. What evidence can be had suggests that the commercial banks draw larger proportions of their borrowers from clerical workers and smaller proportions from wage-earners than do industrial banking companies. Both agencies depend to about the same extent on the professional classes.[18]

Thus, with the qualification that the markets served by individual institutions may vary widely from the general markets sketched above, it may be said that, in their personal lending, industrial banking companies and commercial banks compete for the patronage of substantially the same group of borrowers. A suggestion of the close identity of their consumer markets is contained in the fact that in Massachusetts a case was reported in 1937 and another in 1938 of a commercial bank that had purchased a Morris Plan company as a preliminary to its establishment of a personal loan

[16] See Table 33, p. 136, also National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit*, by John M. Chapman and Associates (1940) Table 34, p. 128.

[17] See Table 34, p. 138; also John M. Chapman and Associates, *op. cit.*, Table 37, p. 133.

[18] See Table 30, p. 131; also John M. Chapman and Associates, *op. cit.*, Table 31, p. 124.

department;[19] similar cases, involving companies not members of the Morris Plan system, are known to have occurred in Pennsylvania and West Virginia. It has also been reported that in other regions commercial banks have substantial stockownership in industrial banking companies, although there is no published evidence on this sort of relationship.

In most states commercial banks have a competitive advantage over industrial banking companies in that besides making personal loans they offer consumers a complete line of banking services. An industrial banking company can offer an equally wide variety of services only if it is operated on a general bank charter or under liberal industrial loan legislation. It is important to note that industrial banking companies which do enjoy the deposit-taking privilege are at present developing a number of non-lending features which place them in virtually the same category as commercial banks.

The making of commercial loans is an aspect of the competitive relations between industrial banking companies and commercial banks that is of growing importance in some centers. It was shown in Chapter 4 that of the 1938 year-end loan-and-discount outstandings of 71 FDIC-insured industrial banking companies, 11.7 percent (over $11,800,000) were classified as "commercial and industrial loans."[20] Since this category excludes personal or instalment loans to individuals other than loans for business purposes, and includes all business loans to individuals, partnerships and corporations, it would appear that at least these insured industrial banking companies are substantial competitors of commercial banks for this type of credit business, just as commercial banks are becoming increasingly important rivals of industrial banking companies in the extension of personal loans.

[19] Massachusetts, *Annual Report of the Bureau of Loan Agencies,* for the license year ended September 30, 1937, p. 2, and *ibid.,* for the year ended September 30, 1938, p. 3.

[20] Table 9, p. 78.

This situation has been mentioned by the Board of Governors of the Federal Reserve System: ". . . there has been an increasing tendency on the part of commercial banks to enter the personal loan field and on the part of Morris Plan banks to accept deposits subject to check as well as time and savings deposits and to make commercial loans."[21] It is worth noting, however, that of the 1938 year-end loan-and-discount outstandings of 961 commercial banks only 3.7 percent ($188,306,000) were classified as personal loans.[22]

A large part of the controversy concerning commercial banks' and industrial banking companies' competition for consumer cash loans and sales financing services centers around the question of the cost of making and collecting loans. This problem is complicated by the fact that consumer loans constitute the main part of the total outstandings of industrial banking companies and only a relatively small proportion of the loans and discounts of commercial banks. As a consequence, when an industrial banking company seeks to determine the cost of making consumer loans it must take into consideration all the expenses, overhead and direct, which are involved in its business, whereas a commercial bank with unused lending capacity, ready personnel and available office space may undertake to make personal loans without allocating any overhead costs to this branch of its activities. Whether the commercial bank will choose to follow this procedure, or will prorate what it considers a full share of overhead expenses to its personal loan department, is an aspect of managerial policy.

It is clear, however, that an industrial banking company is placed at a disadvantage if its commercial bank competitors calculate consumer loan costs without taking account of general bank overhead, and determine their customer charges

[21] Federal Reserve System, *Twenty-fifth Annual Report of the Board of Governors,* covering operations for the year 1938, p. 74.
[22] John M. Chapman and Associates, *op. cit.,* Table 5, p. 36.

in the light of this cost computation. Little is known at present concerning the practice of commercial banks in this matter. Questionnaire returns have revealed that many banks do not attempt to allocate general bank overhead to their personal loan departments, but that an increasing number of banks are making this effort, particularly those operating the larger personal loan departments.[23]

Only very fragmentary information is available concerning the actual rates charged by industrial banking companies; this evidence suggests that, in communities where they compete with commercial banks, their charges are either equal to or slightly higher than commercial bank rates on comparable loans. It should not be forgotten, however, that competition assumes many non-price forms. Such factors as the variety of services offered, the speed with which loans are made, the maturity and other terms of lending, provide possibilities of competition, quite apart from the charge made for the loan or financing service. Like all other consumer credit agencies, industrial banking companies are alert to these possibilities.

Finally, it should be noted that some industrial banking company officials hold the opinion that the participation of commercial banks in the consumer lending field has improved the position of the industrial banking company. This opinion is based on the belief that commercial banks bring to consumer instalment financing a certain prestige that reflects advantageously on the activities of competitors.

COOPERATIVE RELATIONS AMONG INDUSTRIAL BANKING COMPANIES

There are two national trade associations of industrial banking companies—the Morris Plan Bankers Association and

[23] See *ibid.*, pp. 164-66, for a discussion of commercial bank cost accounting procedure.

the American Industrial Bankers Association. The latter organization has one Morris Plan company among its members, but no company outside the Morris Plan system belongs to the Morris Plan Bankers Association.

The older of these two organizations, the Morris Plan Bankers Association, was formed in 1919 and now has its headquarters in Washington, D. C. On October 1, 1939, it had 80 regular and 2 associate members.[24] Its functions appear to consist mainly of gathering and disseminating statistical information, conducting management surveys, representing the legislative and other interests of members and arranging annual meetings at which members convene to discuss their mutual problems. Morris Plan banking companies are organized also in sectional associations, and these have functions similar to those of the national association.

Published information concerning the activities of the Morris Plan Bankers Association is available only in incomplete reports of conventions, published in the *United States Investor*. The two publications of the association—the *Morris Plan Banker* and the *President's News Letter*—are usually avaliable only to its members. In an address to the 1936 convention President Ralph W. Pitman outlined a course of action for the association which throws some light on its activities. He urged the fostering of national advertising, assistance in the development of more Morris Plan banking companies and the encouragement of desired legislation.[25] At its most recent convention it was reported to the membership that legislative activities were being continued and that management surveys had been conducted in 22 companies.[26]

In the early 1930's the Morris Plan Bankers Association was active in arranging an emergency loan plan with the voluntary cooperation of member companies. Each subscriber

[24] *United States Investor*, October 21, 1939, p 1740(58)
[25] *Ibid.*, October 3, 1936, p. 1435(3).
[26] *Ibid.*, October 21, 1939, p. 1740(58).

to the arrangement was to be prepared to advance an allotted quota of funds, not exceeding a total of 2 percent of its capital, surplus and undivided profits, to a common pool which was to provide emergency loans to members. If a Morris Plan banking company were to suffer an unusually large volume of withdrawals, it might inform national headquarters of its need. An official would be sent to make an examination, and his recommendations to headquarters would be communicated to all members of the pool. Each member would then be directed to send its quota to a trustee appointed for the occasion. The advance of funds would involve little risk to the members, since the borrowing company was to pledge notes of its own customers as security and the payments on these notes would soon cancel the loan.[27] This sort of assistance was not often invoked, but many companies regarded its availability as a great advantage.

The American Industrial Bankers Association is of much more recent origin, having been formed in 1934. At present its members number approximately 150, membership being open to companies which have been approved by the Membership Committee. The by-laws, as now amended, contain the following definition of eligibility: "An industrial bank (except those so chartered by law) shall be defined as an incorporated company 51 percent or more of whose loan business is the lending of money and discounting of contracts repayable in weekly, semi-monthly or monthly instalments; and which may or may not issue to the borrower simultaneously with the loan transaction its own written evidence of debt, and whose average total charges on personal loans . . . shall not exceed the maximum amount prescribed for each state by resolution adopted by the Board of Directors of this Association."[28]

[27] *Ibid.*, March 26, 1932, pp. 406(6)-407(7).
[28] "A.I.B.A. By-Laws Approved as Amended" in *American Industrial Banker*, vol. 2, no. 4 (December 1936) p. 13.

The present requirements for membership differ from those originally prescribed. In the beginning the by-laws stated merely that membership was to be limited to "reputable industrial banks."[29] This original position was subsequently modified to require that members should have 90 percent of their loan business in instalment cash loans, and that the average total charge on such loans might not exceed 12 percent per year discounted in advance or 2 percent per month calculated on the unpaid monthly balance.[30] In November 1936 the present "51 percent" requirement was adopted. Since consumer credit agencies which do not take deposits or issue instalment investment certificates are regarded as eligible for membership, the association has some members which cannot be classified as industrial banking companies under the definition adopted in this volume.

The association's activities have broadened rapidly in scope. An important legislative activity has been the formulation of a proposed uniform industrial banking law,[31] and the association also maintains a legislative committee which keeps members informed of current developments. Each year a fairly detailed questionnaire concerning operating methods and credit experience is sent to the membership of the association. The results are tabulated and the data are published in the proceedings of the annual convention.

The association publishes the *American Industrial Banker*, a bimonthly magazine containing articles by persons prominent in industrial lending and allied fields. It has also sponsored the organization of several state and regional associations of industrial banking companies.

[29] "By-Laws, American Industrial Bankers Association" in *ibid*, vol. 1, no. 1 (November 1934) p. 11.
[30] "Industrial Bank Defined at Institute" in *ibid.*, vol. 2, no. 2 (June 1936) p. 6.
[31] See Chapter 2, pp. 54-56.

List of Industrial Loan Laws

THE following is a list of the state statutes under which the industrial banking companies operate. States for which no references are given make no special legal provisions for industrial banking company operations.

Arizona. *1937 Session Laws,* 2nd Special Session, Ch. 13, sects. 1-9, p. 569.

Revised Code (Struckmeyer, 1928), Ch 45, sect. 2006, p. 481.

Arkansas. *Digest of the Securities Laws of Arkansas* (Securities Division, State Bank Department, Oct. 1, 1934), sects. 13 and 40.

California. *General Laws of California 1937,* Vol. I, Act 3603, sects. 1-12, p. 1678.

Colorado. *Colorado Statutes Annotated,* Vol II, Ch. 18, Art. 5, sects. 150-157, p. 303.

Connecticut. *General Statutes* (Revision of 1930), Title 37, Ch. 211, sects. 4031-4041, p. 1306. *Cumulative Supplement 1931-33,* Title XXXVII, Ch 211, p. 460. *Cumulative Supplement 1931-33-35,* Title XXXVII, Ch. 211, p. 649.

1937 Supplement to General Statutes, Title XXXVII, Ch. 211, p. 390; Ch. 211A, p. 391.

Delaware. *Revised Code of Delaware 1935,* Ch. 66, Art. 7, sects. 103-110, p. 546.

Florida. *Compiled General Laws* (Permanent Supplement), Vol. V, 4th Div., Title III, Ch. 2, Sub. Ch. 1, Art. 14, sect. 6150 (1-14), p. 2819.

Compiled General Laws (Permanent Supplement), Vol. I, 1st Div., Title VI, Ch. 3, sect. 1279 (46), p. 513.

Laws 1937, Ch. 17908, p. 404; Ch. 18025, p. 648

Indiana. *Burns Annotated Indiana Statutes* (Cumulative Pocket

Supplement, June 1939), Vol. V, Title XVIII, Ch. 31, sect. 18 (3101-3125), p. 173.

Iowa. *Code of Iowa 1935,* Title XVI, Ch. 332, sects. 6994-6996, p. 1027.

Kentucky. *Carroll's Kentucky Statutes* (Baldwin's 1936 Revision), Annotated, Ch. 72a, Art. 2, sect. 2223b (1-8), p. 1123.

Maine. *Revised Statutes 1930,* Title IV, Ch. 57, sects. 133-141, p. 936.

Laws 1931, Ch. 41, p. 34. *Laws 1933,* Ch. 105, sects. 1-4, p. 242. *Laws 1935,* Ch. 3, sects. 1-2, p. 203. *Laws 1937,* Ch. 102, sects. 1-2, p. 129.

Maryland. *The Annotated Code of the Public General Laws of Maryland* (1939 Supplement), Art. 58A, sect. 19, p. 367.

Massachusetts. *Annotated Laws of Massachusetts* (Cumulative Supplement, 1938), Vol. V, Ch. 172A, sects. 1-14, p. 137, Ch 167, sect. 11A, p. 57.

Michigan. *Compiled Laws 1929,* Vol. III, Title XXIII, Ch. 232, sects. 11973-11996, p. 4243.

Michigan Statutes 1937, Annotated, Vol. XVII, Title XXIII, Ch. 231, sect. 23.34-23.37, p. 64.

Minnesota. *Mason's Minnesota Statutes 1927* (1938 Supplement), Vol III, Ch. 58, sect. 7774 (25-35), p. 1003.

Missouri *Missouri Statutes 1932,* Annotated, Vol. III, Ch. 32, Art. 8, sects. 4979-4985, p. 2280. *Cumulative Annual Pocket Part, 1937,* Ch. 32, Art. 8, p. 67.

Montana. *Revised Code of Montana 1935,* Annotated, Vol. III, Ch. 25, sect. 6109 (1-11), p. 193.

Nebraska *Compiled Statutes 1929,* Title V, Art. 51, Ch. 81, sect. 81 (5101-5111), p. 1659.

Compiled Statutes 1929 (1937 Supplement), Art. 51, Ch. 81, sect. 81 (5102-5106 and 5108-5114), p. 615.

New York. *The Consolidated Laws of New York,* Annotated, Book IV, Art. 7, p. 530.

North Carolina. *North Carolina Code 1935,* Annotated, Ch. 5, Art. 10, sect. 225 (a-r), p. 105.

North Carolina Code 1935 (1937 Supplement), Ch. 5, Art. 10, p. 9.

Ohio. *Banking Laws of Ohio* (Division of Banks 1937), Annotated, sect. 710 (1-180; 2 and 180 especially).

Oregon. *Oregon Code 1930,* Vol. II, Title XXII, Ch. 24, sect 22 (2401-2423), p. 2038.

Oregon Code 1930 (1935 Supplement), Vol. V, Title XXII, Ch. 24, sect. 22 (2405, 2409, 2412, 2414, 2416), p. 483.

Laws 1937, Ch. 303, p. 449. *Laws 1939,* Ch. 238, p. 465.

Pennsylvania. *Purdon's Pennsylvania Statutes,* Annotated, 1939, Title VII, Ch. 27, sect. 761 (1-19), p. 69.

Rhode Island. *General Laws of Rhode Island 1938,* Title XVII, Ch. 145, sects. 1-18, p. 338.

South Carolina. *Code of Laws 1932* (1934 Supplement), sect. 6738, p. 286.

Code of Laws 1932 (1936 Supplement), sect. 7829-1, p. 357.

Texas. *Vernon's Annotated Revised Civil Statutes of the State of Texas 1925,* Vol. I, Title XVI, Ch. 9, Arts. 542-548, p. 659.

Utah. *Revised Statutes of Utah 1933,* Annotated, Title VII, Ch. 6, sect. 7-6 (1-12), p. 193.

Virginia. *Virginia Code 1936,* Annotated, Title XXXVII, Ch. 166A, sect. 4168 (1-11½), p. 1256.

Washington. *Remington Revised Statutes,* Annotated, Vol. V, Title XXV, Ch. 3, sect. 3862 (1-24), p. 633.

Remington's Annual Pocket Part for Volume V, 1939, Title XXV, Ch. 3, sect. 3862 (1-25), p. 633.

West Virginia. *West Virginia Code 1937,* Ch. 31, Art. 7, sects. 3165 (1)—3181 (17), p. 1101.

Wisconsin. *Wisconsin Statutes 1937,* Title XIV, Ch. 115, sect. 115.09 (1-13), p. 1570.

Index

PUBLICATIONS OF THE NATIONAL BUREAU OF ECONOMIC RESEARCH

INCOME IN THE UNITED STATES
W. C. Mitchell, W. I. King, F. R. Macaulay and *O W. Knauth*

*1 Volume I, SUMMARY (1921) — 152 pp.

2 Volume II, DETAILS (1922) — 440 pp, $5 15

3 DISTRIBUTION OF INCOME BY STATES IN 1919 (1922)
O. W. Knauth — 30 pp., $1.30

*4 BUSINESS CYCLES AND UNEMPLOYMENT (1923)
National Bureau Staff and *Sixteen Collaborators* — 405 pp.

*5 EMPLOYMENT, HOURS AND EARNINGS, UNITED STATES, 1920-22 (1923)
W. I. King — 147 pp.

6 THE GROWTH OF AMERICAN TRADE UNIONS, 1880-1923 (1924)
Leo Wolman — 170 pp, $2.50

7 INCOME IN THE VARIOUS STATES: ITS SOURCES AND DISTRIBUTION, 1919, 1920 AND 1921 (1925)
Maurice Leven — 306 pp., $3.50

8 BUSINESS ANNALS (1926)
W. L. Thorp, with an introductory chapter, "Business Cycles as Revealed by Business Annals," by *W. C Mitchell* — 380 pp., $2 50

9 MIGRATION AND BUSINESS CYCLES (1926)
Harry Jerome — 256 pp, $2.50

10 BUSINESS CYCLES: THE PROBLEM AND ITS SETTING (1927)
Wesley C. Mitchell — 489 pp., $5 00

*11 THE BEHAVIOR OF PRICES (1927)
Frederick C Mills — 598 pp.

12 TRENDS IN PHILANTHROPY (1928)
W. I. King — 78 pp., $1 00

13 RECENT ECONOMIC CHANGES (1929)
National Bureau Staff and *Fifteen Collaborators* — 2 vols., 950 pp., $7.50

INTERNATIONAL MIGRATIONS

14 Volume I, STATISTICS (1929), compiled by *Imre Ferenczi* of the International Labour Office, and edited by *W. F. Willcox* — 1,112 pp, $7.00

18 Volume II, INTERPRETATIONS (1931), ed. by *W. F. Willcox* — 715 pp, $5.00

*15 THE NATIONAL INCOME AND ITS PURCHASING POWER (1930)
W I. King — 394 pp.

16 CORPORATION CONTRIBUTIONS TO ORGANIZED COMMUNITY WELFARE SERVICES (1930)
Pierce Williams and *F E. Croxton* — 347 pp., $2.00

17 PLANNING AND CONTROL OF PUBLIC WORKS (1930)
Leo Wolman — 260 pp., $2.50

*19 THE SMOOTHING OF TIME SERIES (1931)
Frederick R. Macaulay — 172 pp.

20 THE PURCHASE OF MEDICAL CARE THROUGH FIXED PERIODIC PAYMENT (1932)
Pierce Williams — 308 pp., $3.00

*21 ECONOMIC TENDENCIES IN THE UNITED STATES (1932)
Frederick C. Mills — 639 pp.

22 SEASONAL VARIATIONS IN INDUSTRY AND TRADE (1933)
Simon Kuznets — 455 pp., $4.00

* *Out of print.*

23 PRODUCTION TRENDS IN THE UNITED STATES SINCE 1870 (1934)
A. F Burns 363 pp, $3.50

24 STRATEGIC FACTORS IN BUSINESS CYCLES (1934)
J. Maurice Clark 238 pp, $1.50

25 GERMAN BUSINESS CYCLES, 1924-1933 (1934)
C T. Schmidt 288 pp, $2 50

26 INDUSTRIAL PROFITS IN THE UNITED STATES (1934)
R. C. Epstein 678 pp., $5.00

27 MECHANIZATION IN INDUSTRY (1934)
Harry Jerome 484 pp., $3.50

28 CORPORATE PROFITS AS SHOWN BY AUDIT REPORTS (1935)
W. A. Paton 151 pp., $1.25

29 PUBLIC WORKS IN PROSPERITY AND DEPRESSION (1935)
A. D. Gayer 460 pp., $3.00

30 EBB AND FLOW IN TRADE UNIONISM (1936)
Leo Wolman 251 pp., $2.50

31 PRICES IN RECESSION AND RECOVERY (1936)
Frederick C. Mills 561 pp., $4.00

32 NATIONAL INCOME AND CAPITAL FORMATION, 1919-1935 (1937)
Simon Kuznets 100 pp., 8¼ x 11¾, $1 50

33 SOME THEORETICAL PROBLEMS SUGGESTED BY THE MOVEMENTS OF INTEREST RATES, BOND YIELDS AND STOCK PRICES IN THE UNITED STATES SINCE 1856 (1938)
F. R Macaulay 586 pp, $5.00
"The Social Sciences and the Unknown Future," a reprint of the introductory chapter to Dr. Macaulay's volume 35 cents; in orders of 10 or more, 25 cents.

34 COMMODITY FLOW AND CAPITAL FORMATION, Volume I (1938)
Simon Kuznets 500 pp., 8¼ x 11¾, $5.00

35 CAPITAL CONSUMPTION AND ADJUSTMENT (1938)
Solomon Fabricant 271 pp, $2.75

36 THE STRUCTURE OF MANUFACTURING PRODUCTION, A CROSS-SECTION VIEW (1939)
C. A. Bliss 234 pp, $2.50

37 THE INTERNATIONAL GOLD STANDARD REINTERPRETED, 1914-1934
William Adams Brown, Jr. 2 vols., 1400 pp., $15.00

38 RESIDENTIAL REAL ESTATE, ITS ECONOMIC POSITION AS SHOWN BY VALUES, RENTS, FAMILY INCOMES, FINANCING, AND CONSTRUCTION, TOGETHER WITH ESTIMATES FOR ALL REAL ESTATE
D L. Wickens (in press)

39 THE OUTPUT OF MANUFACTURING INDUSTRIES, 1899-1937
Solomon Fabricant (in press)

FINANCIAL RESEARCH PROGRAM

I *A Program of Financial Research*

1 REPORT OF THE EXPLORATORY COMMITTEE ON FINANCIAL RESEARCH (1937)
91 pp., $1.00

2 Inventory of Current Research on Financial Problems (1937) 253 pp., $1.50

II *Studies in Consumer Instalment Financing*

1 Personal Finance Companies and Their Credit Practices (1940)
Ralph A. Young and *Associates* 170 pp., $2.00

2 Sales Finance Companies and Their Credit Practices (1940)
Wilbur C. Plummer and *Ralph A. Young* 301 pp., $3.00

3 Commercial Banks and Consumer Instalment Credit (1940)
John M Chapman and *Associates* 318 pp., $3.00

4 Industrial Banking Companies and Their Credit Practices (1940)
Raymond J. Saulnier 192 pp, $2 00

5 Government Agencies of Consumer Instalment Credit (1940)
J D. Coppock (in press)

6 The Pattern of Consumer Debt, 1935-36 (1940)
Blanche Bernstein 238 pp., $2.50

7 The Volume of Consumer Instalment Credit, 1929-38 (1940)
Duncan McC. Holthausen in collaboration with *Malcolm L. Merriam* and *Rolf Nugent* 137 pp, $1 50

Conference on Research in National Income and Wealth

Studies in Income and Wealth (Volumes I-III together, $7 50)
Volume I (1937) 368 pp., $2 50
Volume II (1938) 342 pp, $3 00
Volume III (1939) 500 pp., $3.50

Conference on Price Research

1 Report of the Committee on Prices in the Bituminous Coal Industry (1938) 144 pp., $1 25

2 Textile Markets—Their Structure in Relation to Price Research (1939) 304 pp., $3.00

3 Price Research in the Steel and Petroleum Industries (1939) 224 pp., $2.00

NATIONAL BUREAU OF ECONOMIC RESEARCH
1819 Broadway, New York, N. Y.
European Agent. Macmillan & Co., Ltd
St Martin's Street, London, W. C 2.